Poverty and Global Recession in Southeast Asia

edited by
Aris Ananta and Richard Barichello

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Poverty and Global Recession in Southeast Asia

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ISEAS
INSTITUTE OF SOUTHEAST ASIAN STUDIES
Singapore

First published in Singapore in 2012 by
ISEAS Publishing
Institute of Southeast Asian Studies
30 Heng Mui Keng Terrace
Pasir Panjang
Singapore 119614

E-mail: publish@iseas.edu.sg
Website: <http://bookshop.iseas.edu.sg>

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ISEAS Library Cataloguing-in-Publication Data

Poverty and global recession in Southeast Asia / edited by Aris Ananta and Richard Barichello.
Papers originally presented at a Conference on Poverty, Food and Global Recession in Southeast Asia on 25–26 March 2009 and a Public Seminar on 27 March 2009, conducted by ISEAS in Singapore.
1. Poverty—Southeast Asia—Congresses.
2. Food supply—Southeast Asia—Congresses.
3. Poor—Southeast Asia—Social conditions—Congresses.
4. Food prices—Southeast Asia—Congresses.
5. Financial crises—Social aspects—Southeast Asia—Congresses.
I. Ananta, Aris, 1954–
II. Barichello, Richard.
III. Institute of Southeast Asian Studies.
IV. Conference on Poverty, Food and Global Recession in Southeast Asia (2009 : Singapore).
V. Public Seminar on Poverty, Food and Global Recession in Southeast Asia (2009 : Singapore)
HC441 Z9P6P88 2012

ISBN 978-981-4311-19-9 (soft cover)
ISBN 978-981-4311-20-5 (e-book PDF)

Typeset by Superskill Graphics Pte Ltd
Printed in Singapore by Mainland Press Pte Ltd

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MESSAGE

The 2008–09 global recession is already over. However, at the time this message is being prepared in August 2011, the global economic situation does not look bright. People, including those in Southeast Asia, are worried that another recession may hit the world. As in all crises, the poor will again suffer the most, if another global crisis occurs.

It is therefore that I commend the publication of this book, which examines poverty and the 2008–09 global recession in Southeast Asia. Another important feature of this book is its attention to food security in discussing poverty.

I am happy that Dr Aris Ananta, Senior Research Fellow at ISEAS, and Professor Richard Barichello of the University of British Columbia have brought in experts with various scholarly backgrounds to examine the issue and edit the manuscript. I would like to thank Professor Peter Timmer of Harvard University for his Foreword, which has enriched this book.

Hopefully this book can help us understand poverty and food security, particularly during a financial crisis, not only in Southeast Asia, but other regions in the world as well.

K. Kesavapany
Director
Institute of Southeast Asian Studies

FOREWORD

This volume deals with poverty and food security, two themes related to my own work over the past several decades, the impact of food price volatility on the poor, and the role of structural transformation as a pathway out of rural poverty. This foreword is designed to illustrate the links between these two topics and to highlight several of the important findings in the chapters that follow. To do this it is useful to put poverty and food security into a historical perspective using the structural transformation as a framework.[1]

Historically, structural transformation has been the only sustainable pathway out of rural poverty. It is a general equilibrium process, intimately linked to what is going on in the rest of the economy (Timmer 2009). As Chairman Mao once put it, "the only way out for agriculture is industry".

There are four basic patterns to a successful structural transformation and these have been remarkably uniform:

(1) A declining share of agriculture in value added in the economy (share of GDP) and employment (share of the labour force). Because labour productivity starts out lower in agriculture than outside, there is a gap between the share of agriculture in GDP and in employment, a gap which is gradually eliminated as agriculture is integrated into the rest of the economy. However, recent experience shows this gap often widens before it starts to narrow.
(2) A commensurate rise in the share of urban/industrial/modern service activities.

(3) Migration of rural workers to urban settings to allow this transformation to take place.
(4) A demographic transition with rapidly falling mortality rates, slowly falling fertility rates, and a subsequent period of rapid population growth, which offers a "demographic bonus" when dependency rates drop to low levels for several decades.

The basic cause and effect of the structural transformation is rising productivity of agricultural labour. There are three basic ways to raise labour productivity in agriculture:

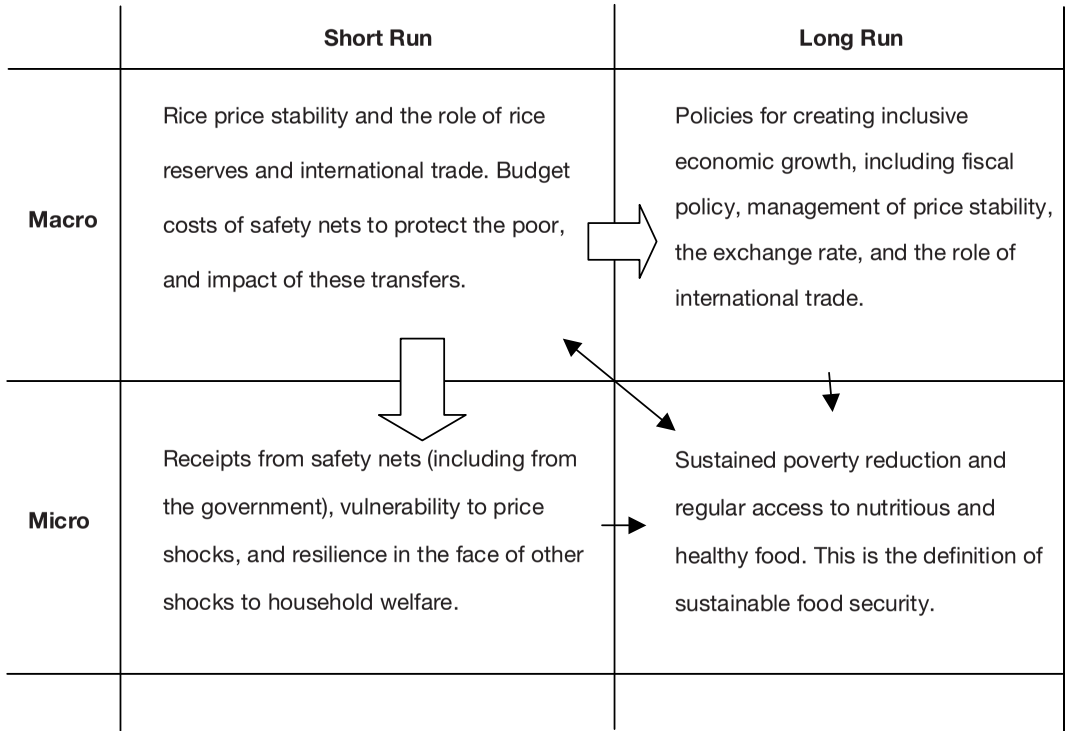
(1) Through higher prices for agricultural output (make it worth more in real economic terms, which may well be happening in the current economic era).
(2) Use of new technology to produce more output for a given amount of labour.
(3) The migration of agricultural workers to other occupations with higher productivity, without lowering farm output (the classic Lewis model of development).

Basic structural forces are behind the remaining poverty and food insecurity in Asia, although this poverty is often exacerbated by sharp spikes in food prices, as illustrated by several of the chapters in this book. Fundamental answers to why this poverty remains in an otherwise dynamic economic region are likely to lie in the realm of political economy, not just economics, as emphasized by Part III of this volume, on "Economics and Politics of Food".

To understand these basic forces in what is otherwise an extremely complicated food system, it is useful to have an organizing framework. The simple framework used here divides the world into issues facing policymakers in the short run (e.g., 1–2 years) versus the long run (5–10 years or longer), and at the macro, economy-wide level versus at the household, or individual level (see Figure 1).

The policy objective in this simple framework is for all households to have reliable and sustainable access to nutritious and healthy food. This is achieved by ending up in the bottom right box of the matrix. The starting point, however, is the upper left box of the matrix, where policymakers deal primarily with macro-level issues in the short run. To the extent they are concerned about the welfare of poor households, in the short run the best they can do is stabilize food prices and send transfer payments — via safety net mechanisms — to those households most affected during a food crisis when prices rise sharply.

FIGURE 1
Basic Framework for Understanding Food Security Issues in Asia


Short Run
Long Run
Macro
Rice price stability and the role of rice reserves and international trade. Budget costs of safety nets to protect the poor, and impact of these transfers.
Policies for creating inclusive economic growth, including fiscal policy, management of price stability, the exchange rate, and the role of international trade.
Micro
Receipts from safety nets (including from the government), vulnerability to price shocks, and resilience in the face of other shocks to household welfare.
Sustained poverty reduction and regular access to nutritious and healthy food. This is the definition of sustainable food security.

Source: Created by the author.

In an ideal world, policymakers could use economic mechanisms under their control to shift households directly to the long-run objective, the lower right box where sustainable food security is achieved. In return, policymakers would receive political support for this achievement, hence the two-way diagonal arrow connecting the upper left and lower right boxes. The diagonal arrow reflects a technocratic view of the world where policymakers take informed actions on behalf of public objectives and are rewarded when they succeed.

In fact, market economies, and politics, do not work that way. Policymakers at the macro level must implement long-run measures to stimulate inclusive, pro-poor economic growth, and sustain that growth for decades in order to have a measurable impact on poverty, via the small vertical arrow connecting the upper right box to the lower right box. These long-run measures are reflected in the broad horizontal arrow from the upper left to the upper right, but it is hard to concentrate the political and financial resources needed to make this arrow an effective mechanism to stimulate economic growth if most policy attention, and fiscal resources, are being devoted to short-run crises.

Simultaneously, and creating tensions for the policies favouring long-run growth, policymakers must also find enough resources, and efficient transfer mechanisms, to ensure that the poor do not fall into irreversible poverty traps during times of economic crisis, including food crises. These transfers can impose substantial fiscal costs and hence challenge the necessary investments for long-run growth. Design and implementation of these transfers involves human and political capital that also has real opportunity costs for the growth process. Thus a focus on the broad downward arrow is necessary to ensure the continued viability and participation of poor households, but these activities have opportunity costs in terms of economic growth.

When the global economy is reasonably stable, and when food prices are well behaved, policymakers can concentrate their political and financial capital on the process of long-run, inclusive growth. Keeping the poor from falling into irreversible poverty traps is easier and less costly in a world of stable food prices, and the poor are able to use their own resources and entrepreneurial abilities to connect (via the small horizontal arrow) to long-run, sustainable food security for themselves. With success in achieving the objectives in the upper right and lower left boxes, market forces gradually — over decades — bring the poor above a threshold of vulnerability and into sustained food security (connecting macro to micro and short run to long run).

By contrast, a world of heightened instability — in global finance and the world food economy — forces policymakers to concentrate their resources in the upper left box, where they are trying to stabilize domestic food prices and

keep the poor from slipping deeper, irreversibly, into poverty. Important as this effort is, it clearly comes at the expense of significant progress out of the short-run box on the upper left, both to the right and from top to bottom. From this perspective, instability is a serious impediment to achieving long-run food security. In a world of greater instability, induced by climate change, by new financial arrangements, even by the pressures from new political voices, food security is likely to suffer.

How can we fix this? The first step is to understand how the world of food security has changed in the past several decades. Where has the food system come from over the past half century or so (roughly my own professional life)?

(1) There was a broad political mandate in Asia to feed both urban and rural populations, a mandate not seen as clearly in much of Africa.
(2) A technological revolution in rice and wheat was coupled with (reasonably) good policies and public investments in rural infrastructure to make this mandate (largely) possible.
(3) Rapid, inclusive economic growth (resulting largely from [1] and [2]) gave (most) Asian households access to the food in their fields and markets.

What has changed is the structural transformation: it has been driven by these processes (and the changing role of rice in the economy). Asia is now richer, more urban, better connected both within each country and across borders, and it is much better fed. These changes have dramatic implications going forward; four key issues need to be addressed.

First, farm size is still declining, with an especially worrisome rise in the number of "micro farms", those under 0.2–0.3 hectares. Can such small farms survive by adopting new technology?

Second, integrated technologies combining new genetics, agro-chemicals, and management techniques will increasingly be the route to higher crop (and livestock) productivity. But these integrated technologies have lots of science built into them, are very knowledge intensive in the use of the inputs, and require highly sophisticated management techniques to be successful. Thus these integrated technologies may have important scale economies in total, even when the individual components appear to be scale neutral.

Third, reaching small farmers with modern inputs and buying their increasingly diversified outputs will require a new, information-intensive marketing system — a supply chain if you like. Supermarkets, because they have access to the consumers who are buying these outputs, will drive these new supply chains.

Finally, perhaps the toughest question is "scalability". That is, as donors and policymakers, how do we learn what works for small farmers? How do we get their output to demanding consumers? And how do we accomplish these tasks on an economy-wide scale? Historically, only market processes have managed to be scalable, but these market processes do not necessarily care whether small farmers survive or poor people get enough to eat.

There is our challenge!

C. Peter Timmer
Professor Emeritus, Harvard University

Note

1. This foreword draws on my paper "Structural Transformation and Food Security in Asia: Small Farmers, Modern Supply Chains, and the Changing Role of Rice in Asia" (paper presented at the meeting of the International Economics Association [IEA], Tsinghua University, Beijing, 4–8 July 2011).

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Timmer, C. Peter. "A World without Agriculture: The Structural Transformation in Historical Perspective". Henry Wendt Lecture, American Enterprise Institute, Washington, DC, 2009.

PREFACE

Financial crises after financial crises have occurred, but for many countries the last one, the 2008–09 global recession, has been the deepest since the 1930s great depression. This book started with an objective to understand the impact of high inflation on poverty and food security in Southeast Asia and authors had been contacted to write on this subject. However, the global economy moved quickly into recession in 2008. Global recession has also come to Southeast Asia.

Anticipating that the impact of global recession would be more severe than that of high inflation in Southeast Asia, we refocused the title of the book to *Poverty and Global Recession in Southeast Asia*. A closed-door conference presenting and discussing the first draft of the papers was conducted on 25–26 March 2009. Some important points from the conference, particularly related to Southeast Asia in general, were presented by Aris Ananta and Richard Barichello, the coordinators of the project, in a public seminar "Poverty, Food, and Global Recession in Southeast Asia" on 27 March 2009, the following day after the conference. In the public seminar, Tan Ern Ser and Yothin Jinjarak, also paper writers in the conference, made presentations on issues related to Singapore. Both the closed door conference and public seminar were conducted by ISEAS in Singapore.

During the revision and editing of the chapters, world financial and economic development continued to change. By early 2010, people were already optimistic that the global recession was over or would be over soon. However, the evidence was mounting that the poor had suffered and were still suffering from the current global crisis, even if the richer individuals may have recovered. Therefore, an important question arises, "Is the crisis really over for the poor?"

The book is not intended to present the most recent events of the Southeast Asian economy or the situation of the poor and food security. Instead, this book is a modest attempt to contribute a better understanding on poverty and food security in Southeast Asia during the recent global recession considering both recent developments and the previous major crisis of 1997–98.

We are very thankful to Dr Collin Duerkop, the then Regional Representative for Southeast Asia, Konrad Adenauer Stiftung (KAS), Singapore, who has funded the conference and public seminar. We would also like to acknowledge the full support of Ambassador K. Kesavapany, Director of ISEAS, for this project. We also appreciate the contributions of Dr Chin Kin Wah, the then Deputy Director of ISEAS, who had continuously encouraged interdisciplinary studies, such as the one conducted for this book. We appreciate the hard work of the administrative staff of ISEAS, including Tee Teo Lee and Karthi Nair, for organizing the conference and seminar. Without the hard work and careful copy-editing by the Publications Unit of ISEAS, particularly Stephen Logan, the book would have never been published. We are also indebted to the chairpersons of the conference (Dr Chin Kin Wah, Dr Terence Chong, Dr Tin Maung Maung Than, Dr Aekapol Chongvilaivan, Dr Melanie S. Milo, and Ambassador Jørgen Ørstrøm Møller) as well as the participants in both the conference and public seminar for their comments for the improvement of the papers.

And last but not least, we owe much to the important contributions of all the paper writers to this book who have made this book what it is.

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POVERTY AND FOOD SECURITY IN UNCERTAIN SOUTHEAST ASIA

Aris Ananta and Richard Barichello

POVERTY BEYOND CRISIS

The financial market crashes. The wealthy suffer. A financial crisis follows, and with a lag, the real sector is attacked. Demand tumbles. Employment opportunities fall. Lower and middle income classes feel the impact. At least, they have to change their lifestyles, but some become poor or near poor. The already-poor suffer much more. Governments in the affected countries, international organizations, and other interested parties discuss seriously the causes of the crisis and examine various policies to exit from the crisis.

This is what happens during a crisis, including the recent 2008–09 global crisis. The 1930's Great Depression, the 1997–98 Asian crisis, and the recent global recession were preceded by strong economic growth, optimism, and, especially recently, the dramatic rise in the contribution of the financial sector to the region's gross domestic product (GDP). All were triggered by a financial crisis. It initially hit selected employment, particularly those working in financial sectors, which were mostly in the middle and upper income groups. Then it spread to real sectors, affecting a wider set of jobs including lower income groups and the poor. It would appear that almost nobody can hide.

Moreover, the poor have and will have suffered the most, with food as the most important item in the expenditure of the poor. Whatever happens to food significantly affects the welfare of the poor. In Chapter 4 Thant describes

how the poor people of Laos have been affected by the global crisis. They have been successful in reducing poverty, but their recent global exposure may have temporarily reduced the success in poverty reduction. Learning from what happened in the 1997–98 crisis, Boonyamanond and Punpuing show in Chapter 12 how the Thai economic miracle was eroded drastically by the 1997–98 crisis.

In all crises, the non-poor also suffered. Some became poor, some were still above the poverty line, and some even remained rich, but their wealth had been much reduced, resulting in a feeling of insecurity. These people are usually the groups of people who have stronger political voices and hence their relative suffering may be heard more strongly in both domestic and international circles.

The following is an observation by Ananta (2003, p. 8) on what happened during the 1997–98 Asian crisis in Indonesia.

> Life was like a roller-coaster with one difference. This ride has no predictable end. People used to enjoy prosperity and rising expectations, with many plans for the years ahead. Suddenly and dramatically, their wealth, at least on paper, plummeted. They might have discussed poverty earlier, but they never experienced being poor, though they were still far from subsistence level. Statistically, they were not recorded as "poor" but they felt terribly poor. Another distinguishing character is that they had strong political voice. They mostly included the elite, such as scholars, politicians, bureaucrats, business persons, journalists, and those who work in NGOs

A similar situation was found in Singapore during the recent global crisis. There is no unemployment insurance and therefore people have to struggle to do whatever work they can to survive. Chua (2009) described that these people worked in "survival jobs", hopefully temporary low-paying jobs, until they get back to their decent jobs. They need these jobs to survive. These jobs erode the self-esteem of individuals and create embarrassment among relatives and friends, resulting in emotional crisis, aggravating the financial crisis.

The fact that the non-poor, particularly the rich, have suffered a lot during financial crises, especially in developed economies, may be one of the important explanations for why people in rich economies are preoccupied with financial crises, although they are not so concerned with poverty during "normal" (non-financial crisis) times. The developing countries, especially the very poor ones, have always been in crisis, though they have not developed modern financial systems. The poor, because of their poverty, do not have the political power to voice their concerns in international arenas.

When this chapter was being written, in March 2010, the world recession seemed to be over, though it was not certain whether it would be a quick or a slow recovery. People already talked about "post crisis" and forgot the search for a better development paradigm.

Perhaps the greatest concern of the people in rich economies should pass beyond the recent crisis, to include long-term real poverty among the very poor in the world. Any solution to the recent crisis should also be related to the achievement of the Millennium Development Goals. The recent global crisis may have eroded much progress in poverty reduction in the world in general and Southeast Asia in particular.

Furthermore, food is a crucial component in poverty issues because expenditure on food usually accounts for most of the income of the poor. The food crisis has led to an alarming warning from some leading world politicians. A report for ministers of the G-8 (Group of Eight Nations), prepared in April 2009, mentioned a possible permanent global food crisis. The increasing world population will necessitate a rapid increase in world food production, especially in developing countries. Otherwise the world will face a structural food crisis, which will bring insecurity and instability in world politics (Blas 2009).

This book aims to make a modest contribution to the understanding of the recent global crisis by focusing on food and poverty in Southeast Asia. It consists of four parts. The first part provides an introduction to the book. It discusses the recent world crisis in general and in particular its impact on world poverty and food security. It also takes a special focus on social security in Southeast Asia.

The remaining parts concentrate on issues in Southeast Asia. The second part focuses on identifying the poor. Who are the poor, demographically, socially, and politically? The third part examines the economics and politics of food, particularly rice. The impact of the recent global crisis on poverty and its coping mechanisms are studied in Part IV. The chapters are arranged by topics, rather than countries.

The rest of this chapter presents some important points examined in the book. It consists of a discussion on the world recession and social security in Southeast Asia, who the poor are, the economics and politics of rice, impacts of global recession on the poor, and social safety nets.

WORLD RECESSION AND SOCIAL SECURITY IN SOUTHEAST ASIA

The 2008–09 global crisis can be traced to the encouragement of the U.S. government towards home ownership and an excessive and irresponsible

expansion of loans, even to those who did not qualify for borrowing — the so called "sub-prime mortgage crisis". The rising price of properties was the reason why the banks dared to provide such loans and households were not afraid to take such a risk. Banks and households believed that the price of the houses would keep rising and the houses could be resold at a profit whenever the households had problems in paying back the loans. Suddenly, interest rates rose. The households could not repay their loans. From there, in August 2007, the global crisis started — after some self-denial that the "financial crisis" in August 2007 would rage all over the world.

During the 1997–98 Asia crisis, Indonesia was the hardest hit country, followed by Thailand. Indonesia's GDP declined by 13 per cent; and Thailand's, 10.5 per cent in 1998. Singapore was the least-affected country, with a decline of only 1.4 per cent. The situation is, however, different during the 2008–09 global crisis. Five Southeast Asian economies (Brunei Darussalam, Cambodia, Malaysia, Singapore, and Thailand) contracted in 2009. Singapore was one of the hardest hit countries. The economic growth rate declined to 1.4 per cent in 2008 and even minus 2 per cent in 2009, after having growth rates of at least 7.5 per cent in 2004–07. On the other hand, Indonesia maintained a positive, though lower, economic growth, at 4.5 per cent in 2009.

Learning in part from the Asian 1997–98 crisis, Barichello (Chapter 2) anticipated a substantial increase in poverty because of the fall in non-farm/urban incomes. The 2008–09 recession coupled with the 2006–08 food price spike created a rollercoaster of economic growth and increasing food prices. This has included a serious recession for many countries in Southeast Asia that not only lowered growth rates in all countries but lowered incomes in many. Despite the rebound in growth in 2010, this recession has serious implications for those in poverty. During the period of this recession, Barichello observed a reversal of the gains in fighting poverty that had been achieved in the past decade. An important element of these lowered incomes is that this recession and the slightly earlier food price inflation are having a negative impact on food security. Although this is only one aspect of poverty, it is particularly relevant because food accounts for such a large share of poor families' expenditures. In addition, it is especially important for future income earning opportunities due to the effects of food insecurity and resulting nutritional deficiencies on those most vulnerable — children and women.

These issues are particularly important for the rural poor. This is where most poor people are found and they are on average net food consumers in most countries in Southeast Asia. Therefore they are hurt, not helped,

by the food price spikes that have occurred. In addition, in most countries they are quite tightly connected to the urban economy due to migration and the linkages between wage rates in urban and rural areas. In other words, the rural and agricultural poor are not immune to the effects of a recession, despite the fact that food demand does not change dramatically with changes in incomes. Rural areas suffer the same loss of incomes and even experience falling wage rates from the mainly urban recession that has just occurred. The spike in food prices has just exacerbated the situation. Indeed, nobody can hide from a recession in an increasingly globalized and domestically integrated economy. These linkages and the serious effect that this recession has had on incomes in general and poverty in particular mean that poverty reduction policies may have to be renewed, expanded, and in some cases reconsidered in the wake of this 2008–09 recession.

From the review of past crises and the nature of rural poverty, several policy options can be identified to deal with this problem. In the short and long run, it is critically important to maintain and encourage overall economic growth. Achieving strong economic growth is a tide that can lift all boats, including those within poverty in both urban and rural areas. Therefore, it should be seen as a priority in anti-poverty strategies for rural areas. If food prices remain high, which is likely and which cannot realistically be changed over the intermediate run, a strong growth strategy will be able via increased wage rates and/or earnings to offset high food prices and still reduce poverty. This growth strategy should be designed to include growth outside the major urban centres and include smaller towns in rural areas. More education for young people in rural areas is also a prerequisite for poverty reduction, but this is not a short term strategy.

The other major component of reducing rural poverty has to be increased agricultural productivity. This too is a long-run strategy involving investment in agricultural research as well as extension programmes to inform farmers of their options to use improved techniques for agricultural production and management of key inputs, research findings, and new varieties of crops, trees, and livestock. Although it has been unfortunately neglected worldwide over the past several decades, this is no excuse for continuing to underinvest in this very effective anti-poverty policy and efficient stimulus to national development. Targeted income support to the poor is a third option and the only quick-acting measure to alleviate the negative effects of the current recession. However, it requires a moderately sophisticated infrastructure of institutions to deliver such income support without substantial corruption, an infrastructure that many poor countries do not possess.

As discussed by Ramesh in Chapter 3, the governments of Southeast Asia have learnt a lot from the 1997–98 Asian crisis. They have reacted to the recent global crisis much better than they did in 1997–98. They also paid attention to protect the poor from the worst impact of the crisis. However, Ramesh argues that the best time to prepare the social security system is before the crisis, rather than during the crisis. Furthermore, he shows that the countries in Southeast Asia have not done anything important for their social security. The governments in Southeast Asia have all implemented stimulus packages, as have other countries in the world. They do it to boost the economy, to raise the aggregate demand of the economy. Nevertheless, the stimulus package is not a programme to protect vulnerable groups, those who are most affected during a crisis. Indonesia is the only country in Southeast Asia that has continued improving its social security system after the 1997–98 crisis. Ramesh recommends that the governments be responsible for any economic crisis. Global economic crises are similar to natural crises, they cannot be predicted. The impact is too large for many individuals to cope with by themselves. Here is the role for sovereign governments to play.

WHO ARE THE POOR?

At least three questions are important in examining these crises. Who are the people who have suffered? To what extent have they suffered? Do all people suffer from the crises or are there some who prosper?

In Chapter 4, Thant describes poverty in Laos, a poor country which has grown relatively quickly in the last twenty years. Low education causes poverty; and being poor results in inability to attain higher education. As of 2005, the literacy rate among the population aged fifteen years and over was still low, at about 73 per cent. Yet Thant argues that Laos has actually made significant progress in reducing poverty and providing basic education services.

The issue has become more complex with Laos' ethnic and geographical heterogeneity. The poverty rate among the Lao-Tai group was only about 25 per cent, but it reached about 46 per cent among the Sino-Tibetan group. The rate was only about 28 per cent in the lowland areas, but about 44 per cent in the uplands. The relatively large number of languages and cultural norms contributes to the huge problem of enhancing education, and reducing poverty, in Laos.

The issue in Laos is strikingly different from that in Singapore and Malaysia, where the rates of absolute poverty have been relatively very low. In these countries the issue is more one of unequal distribution and the fulfilment

of rising aspirations. Hassan and Mustafa examine Malaysian regional income disparities in Chapter 5. Regional income inequality occurs in Malaysia mostly because of industrial imbalance. They argue the existence of an economic and demographic "disadvantage cycle". The manufacturing activities of the less-developed states are mostly resource-based and labour-intensive industries. The products of these activities are mostly for the domestic market. More educated and experienced labour has migrated to the developed states. At the same time, the condition of being less-developed also hints at unfavourable prospects for investors, who can bring capital to less-developed states.

This situation has perpetuated the inequality of regional income in Malaysia, starting from the British colonial period following the strategy of "building upon the best". The situation has become more complicated because of racial divides following regional inequality. The Malays mostly lived in the less-developed states of Trengganu, Kelantan, Perlis, and Kedah. The Chinese and Indians mostly lived in the more-developed states.

The government has implemented three strategies to develop less-developed states. One is to increase the quality of life, particularly via education and health programmes. The second is to provide an extra incentive for capital-oriented industries. The third is to increase government investment in subsidiary companies. However, the increase in education and health has resulted in out-migration from the less-developed to developed states. The incentive to invite capital to the less-developed states has not worked because of the lower economic prospects in the less-developed states. The subsidiary companies spurred growth, but not by much, because the growth was more capital-driven than productivity driven.

In Chapter 6 Tan is concerned with the welfare of the current middle class, middle-aged people who are in the "sandwiched" generation, in Singapore. On one side, this generation has to take care of its long-living ageing parents, who are often not in good health and therefore require substantial health expenditures. On the other side, this generation still has to be responsible for ensuring their children perform well academically so that they have a better chance to move up socially. It is a cruel reality to experience downward social mobility in middle age.

The late seventies and early eighties were the golden age of the mobility game in Singapore, with the state as the controller and manager of the game. The state ensured that people would be rewarded sufficiently if they followed the rule of the game — meritocracy — thanks to the strong economic growth and tight labour market at that time. This is also the time when the 5 C's (cash, credit card, condominium, car, club membership) became the Singapore equivalent of the American Dream. Poverty was

perceived as a reflection of moral shortcoming because people believed that poverty and low income could be eradicated by following the educational path and hard work.

Unfortunately, as Tan also showed, playing the game may have become tougher as a result of global recession and competition. Furthermore, Singapore has experienced several crises at shorter intervals since the 1985–86 recession. The most recent crisis, the 2008–09 great recession, has also refuted the general perception that it was the working-class jobs which were the most insecure in Singapore. During the crisis, middle-class jobs also suffered a lot. The path of a comfortable middle-class career seems to have gone.

Tan recommends that the government provide more help to the middle class, middle-aged people, to avoid them becoming a working-class society. Such efforts will increase the government's legitimacy.

Indonesia's case is a mix of both Laos on one hand and Malaysia and Singapore on the other. Ananta and Arifin in Chapter 7 show that consumption poverty has been on a declining trend, even during the recent recession, measured by three indicators of poverty: poverty rate (indicating the percentage of the population who are poor), index of depth of poverty (the gap between the poverty line and mean of the expenditure of the poor), and index of severity of poverty (the variance of the expenditure of the poor). The feature of consumption poverty in Indonesia is its very large number, 32.5 million in 2009, because of Indonesia's very large population. Progress in non-consumption poverty is, however, mixed.

Ananta and Arifin also conclude that most of the poor and non-poor households own houses. The poor even had a higher percentage (87 per cent) of house ownership than the non-poor (82.8 per cent). However, poverty is also associated with the characteristics of these houses. The poor are less likely to live in houses with brick walls, more likely to live in small houses, and in houses with poor construction. The poor are also less likely to live in houses with good infrastructure such as with electricity for sources of light, access to clean drinking water, and availability of toilets in the houses.

The poor household is more likely to be larger than the non-poor household, but this gap has become smaller. There has also been an increase in the number of women-headed poor households. The age of the head of the poor household has been older, reflecting population ageing in Indonesia.

As expected, education is (negatively) associated with poverty and rising education may have helped more of Indonesia's population to leave poverty. The agricultural sector remains the sector mostly taken by the head of the poor households. The head of the poor household is also more likely to be self-employed or to work assisted by unpaid workers.

Another feature of poverty is seen in Cambodia. Chan, in Chapter 10, describes that about 4.3 per cent of Cambodian households were chronically food insecure. They were the most vulnerable group during periods of rising food prices. About half the food insecure group lived in rural Tonle Sap. They had more children than the urban poor and had higher dropout rates among primary school children. They were also more likely to be landless compared to the overall rural population.

In Chapter 14, Anh examines the complicated social issues related to urban poverty, another feature of poverty in Southeast Asia. In large cities such as Hanoi and Ho Chi Minh City, the poor chose to live in inner urban areas to make it easier for them to go to work. On the other hand, those without stable jobs stay in temporary shelters with poor infrastructure and unhealthy environments.

ECONOMICS AND POLITICS OF RICE

The recent global recession was preceded by a period of high inflation. Prices of fuel and food skyrocketed, partly agravated by speculative motives from those who avoided the gloomy financial market. With the recession, prices fell. However, did the price of rice return to the level before the rapid rise of price? Declining inflation does not mean that the price declines, it only means that the rate of increase of the price declines. The question, nevertheless, remains on how people, particularly the poor, have been affected by the rapidly rising price of rice. How do people, especially the poor, benefit from declining inflation?

It is not surprising, therefore, that the availability and price of food, particularly rice, in Southeast Asia has become a highly sensitive political issue. In Chapter 8, Patunru and Basri describe that rice, the most politicized commodity in many countries, including Indonesia, is the most important source of income for small farmers and agricultural households. Rice is a crucial commodity for Indonesia and Indonesia is usually a net importer of rice. Furthermore, because more than 75 per cent of the poor are net consumers of rice, an increase in the price of rice hurts the poor.

Therefore, there should have been opposition to trade protection so that the price of rice would become cheaper, helping the poor. However, as Patunru and Basri show, trade in rice has been protected since 2000. More interestingly, there have been few protests against the restriction from consumers. This policy of trade restriction, resulting in a higher price of rice, is contrary to that for fuel. The government has subsidized the price of fuel. Cuts in the subsidy are often followed by strong protests.

Politics dominates. Trade restrictions in rice are applied because of politics favouring the rich farmers, absentee landlords, and other interest groups, though this policy hurts the poor. Worse, government officials often release even conflicting statements. In 2007, the Coordinating Minister for Economic Affairs allowed BULOG (Badan Urusan Logistik, a government agency to stabilize the price of domestic rice) to import rice. However, the Minister of Agriculture said that there was a surplus of rice production and, therefore, there was no need to import rice. Contrary to the rice policy, the Indonesian public protested the export of oil, so that the oil could be allocated to domestic use and hence lower the domestic price of fuel.

Patunru and Basri conclude that net rice consumers are politically too weak to fight the groups of rice producers to protest trade restrictions on rice. On the other hand, fuel consumers are politically strong enough to force the government to maintain the subsidy on the price of fuel. They recommend that the role of YLKI (Yayasan Lembaga Konsumen Indonesia, the Indonesian consumers' foundation) be strengthened so that it can help the consumers of rice to push the government to lift the trade restriction on rice. For fuel, the government should continue cutting the subsidy and, at the same time, provide a compensation scheme such as a direct cash transfer programme for the poor.

Tigno, in Chapter 9, mentions that food and politics have become strange bedfellows in the Philippines. In the Philippines rice is not simply a staple food. Rice is mostly a political commodity. The poorest spend the largest share of their expenditures on rice. Therefore they are most likely to suffer because of the increase in the rice price. Providing a subsidy during a period of rocketing rice prices not only can help the poor, but the government can also receive important political support from the poor. The incumbent in any presidential election has always tried hard to keep the price of rice low. Rice has always been an election issue.

Rice subsidies have also often been distributed in the large metropolitan cities, where actually there is no significant poverty level. However, these cities often form a very important political voice.

The NFA (National Food Authority) functions to provide affordable rice to consumers and, at the same time, provide sufficient incentives for producers to sell their rice. It should buy the rice at high prices from farmers, sell at low prices to customers, and keep storage levels high enough to stabilize the price. This results in excess demand with accompanying long queues to get this rice.

Tigno concludes that the NFA has always suffered from high operating costs. The subsidy from the government is often not sufficient to cover these

high costs. During the recent global recession, the outstanding debt of the NFA in 2008 was more than double that in 2007.

In Chapter 10, Chan elaborates on the small and open economy of Cambodia which has a surplus of some crops such as rice, soybeans, maize, cassava, cashews, sesame, and rubber. Therefore Cambodian farmers benefit from high world prices of these commodities. However, in 2008, the price of agricultural products fell significantly while the cost of production was still high. Many farmers suffered or gained only small profits in the first half of 2009.

On the other hand, analysing the data from a national survey conducted in June 2008, Chan finds that net food consumers suffered from higher prices of food, except those who could switch to other jobs which gave them higher wages to compensate for the higher food prices. The very poor had to struggle daily to get sufficient food.

He shows that prices of food went up rapidly in the first half of 2008. The year-on-year consumer price index rose from 13.7 per cent in January 2008 to 25.7 per cent in May 2008. These rapidly rising prices before the national election in July 2008 might have resulted in the absence of the statistics in June 2008. The index rose to 36.8 per cent in July 2008 before declining to 23.2 per cent in December 2008. Worse, the price of rice rose more dramatically. It skyrocketed by about 100 per cent in May 2008. Its increase slowed down but it was still 70 per cent higher in December 2008 than a year earlier.

In other words, higher prices of agricultural commodities bring large profits for producers and traders, but net food consumers, especially the poor, suffered. Among the poorest two quintiles of the population, food expenditure formed 70 per cent of total household expenditure.

In Chapter 11, Chongvilaivan examines the possible impact of the world price of fuel on domestic rice prices in Thailand. There are some ways the rising price of world fuel raises the domestic price of rice: rising cost of production of rice, intensifying speculation in rice markets, shifting rice demand, and production of biofuels.

He finds that in the long run the domestic rice price responds to the changing world price of fuel. But the impact of the current global recession, droughts, and export restrictions on domestic rice prices is also only temporary. The domestic price of rice is likely to soon return to its long-run trend price.

Therefore he recommends that the Thai Government focus on a long-term agricultural strategy such as productivity improvement and infrastructure. Government intervention such as subsidies and quotas will

create market distortions. He argues that this market distortion will hurt both consumers and producers. He also suggests that the government minimize the impact of world fuel prices on domestic rice prices, to keep the Thai poor from hunger.

IMPACT OF GLOBAL RECESSION ON POVERTY

As the global recession appears to be over, it is timely to question the extent to which poverty in Southeast Asia was affected by this recession. Moreover, more than ten years have elapsed since the Asian crisis. More data and analyses have been available on that crisis, so it is timely to look at what happened at that time, particularly the impact on poverty. This section starts with what we can learn from the 1997–98 Asian financial crisis, particularly from Thailand, the country where that crisis began, with its economic growth rate plunging by 1.4 per cent in 1997 and a much deeper contraction of 10.5 per cent in 1998.

Boonyamanond and Punpuing (Chapter 12) examine the impact of the Asian crisis on employment, migration, and poverty in Thailand. They show how individuals and households were severely hit but the impact varied across socio-economic and demographic groups. The labour market was seriously affected. Those who had earlier migrated to urban areas such as Bangkok and worked in non-agricultural sectors were forced to return home during the crisis, particularly to the north and northeast regions. The agricultural sector and the regions of origin of the migrants had to act as the country's social safety net.

The crisis also worsened poverty in Thailand, particularly in rural areas. The severe impact on poverty was seen only in 2000, unlike the labour market which suffered most two years earlier, in 1998. The northeast region was the hardest hit, mostly because of lost economic opportunities in Bangkok and the reduction in remittances from Bangkok.

A similar case can be observed in Cambodia during the recent global crisis. One of the poorest countries in Southeast Asia, Cambodia had shown its economic muscle since the early 1990s when it was growing at about 6 per cent annually. Then the economy was hit by the Asian crisis, hastened by political tensions in 1997. Since then, as described by Chan in Chapter 10, the economy resumed its rapid growth, achieving its peak at 13.3 per cent in 2005. During the recent global crisis, economic growth remained relatively high at 6.5 per cent in 2008.

Chan further shows that the real impact of the crisis was only felt in 2009, when growth turned negative. This contraction was seen particularly

in tourism, construction, and garments, three of the four pillars of the Cambodian economy. Another pillar, agriculture, continued to grow at 5 per cent in 2009, which buffered the impact of the global crisis. He argues that economic contraction in a poor country such as Cambodia may jeopardize the long-term efforts in human development.

Singapore is also a small country, but it is the richest economy in the region and one of the most open economies in the world. As a consequence, the performance of the domestic economy is heavily influenced by what happens in global markets. Jinjarak (Chapter 13) examines particularly the impact of openness in international trade on wage inequality in Singapore. He shows that the expenditure of low-income households shifted more to buying imported food. Unlike in the United States where globalization benefited low-income households by providing cheaper imported products from China, globalization in Singapore has resulted in higher inflation within the low-income household's shopping basket. The higher inflation rate in turn increased income inequality.

Indeed, income inequality had risen even before the 2008 recession. In 1998, the ratio of the income of the highest quintile to that of the lowest quintile households was thirteen in both the United States and Singapore. However, during the 1998–2008 period, the ratio only doubled in the United States, but in Singapore it increased much more, ten-fold since 1998.

Jinjarak also shows that immigration resulted in a higher skilled-wage premium and therefore it increased wage inequality in Singapore. The result is the opposite of what is found in the United States, where immigration has reduced wage inequality. He also finds that the trade deficit in non-durable goods is associated with a lower skill premium, and therefore lowered wage inequality.

Assuming that nothing else (including policies) changed, Jinjarak's exercise indicates that the global recession would widen wage inequality in Singapore. However, the final impact will also depend on other factors such as the changes in savings and wealth as well as on government policies (including the stimulus package implemented during the crisis).

Globalization, meaning increased integration of country economies around the world, has also taken its toll on the Laotian economy. In Chapter 4, Thant shows how the recent global crisis may have eroded the substantial progress Laos has made during the last ten or twenty years, where it enjoyed high economic growth accompanied by rising education levels and declining poverty rates. The reason for the serious impact is the relatively high degree of integration of the Laotian economy with the world market, particularly through exports, tourism, and foreign direct investment. The segments of the

population most likely to be hurt were the urban poor in the formal sector and those who depended on remittances.

The urban poor also suffered seriously in Vietnam, which has experienced two "contrasting" economic crises consecutively. As described by Anh (Chapter 14), in May 2008, the Government of Vietnam was very busy cooling down the economy, which had been overheated with double-digit inflation. It imposed tight monetary and fiscal policies. Therefore, by the end of 2008 the story was very different: Vietnam was confronted with the global recession, through a decline in its exports. The government reversed its policies. It became concerned with how to stimulate domestic aggregate demand and how to deal with the negative social impact of the recession. However, Anh argues that there had been insufficient attention from the government on the impact of the crisis on the poor, including the urban poor.

The people in Sarawak, Malaysia, also suffered from double economic woes. Ling and Wong (Chapter 15) show that inflation had risen and reached its peak in the third quarter of 2008. The rate then slowed to 3.9 per cent in January 2009. However, declining inflation meant only that the rate of increase of the price level declined. As long as inflation was still positive, the absolute level of prices kept rising, meaning continuously higher costs of living. Then the global recession hit Malaysia, including Sarawak. The declining growth rate, combined with the rising cost of living, squeezed low income groups, especially the large urban families. Ling and Wong argue that urban families had more difficulties in facing a rising cost of living than their rural counterparts, because the latter have more options for income sources and consumption.

By contrast the recent global recession had a minimal impact in Indonesia. In Chapter 7, Ananta and Arifin point out that the recent recession did not have much impact on the Indonesian economy, which experienced a relatively high 4.5 per cent economic growth rate in 2009. The poor even seemed to have "enjoyed" this recession, because of lower inflation (and sometimes a declining absolute level of price) through the period of declining aggregate demand. Coincidentally, 2009 was also the year of parliamentary and presidential elections in Indonesia. The very large spending for the campaigns may have contributed to the continuing decline in poverty. Furthermore, the government continued to implement a major programme of social safety nets, including those introduced in 2008 and 2009. These political circumstances and the existence of social safety nets may have helped the continuing decline in poverty amid the worldwide recession.

However, the experience of Indonesia during the recent global recession is not the same as its experience during the 1997–98 Asian crisis. The trend of

declining poverty since the early 1970s ended during the Asian crisis. Poverty rose from 17.5 per cent in 1996 to 24.2 per cent in 1998.

The Philippine experience is different from that of Indonesia. As described by Tigno in Chapter 9, the Asian crisis raised Philippine poverty only slightly from 36.7 per cent in 1997 to 37.5 per cent in 1998. Measured with self-rated poverty, the Philippines also suffered during the 2008–09 global recession, when its GDP grew at only 3.8 per cent in 2008 and 0.9 per cent in 2009. It should be noted, nevertheless, that there had been no significant improvement in self-rated poverty in the Philippines since 1983.

SOCIAL SAFETY NETS

In Chapter 12, Boonyamanond and Punpuing describe how the Government of Thailand responded to the global financial crisis, particularly in helping the poor. Learning from the Asian crisis, the government immediately launched a stimulus package, based on King Bhumibol Adulyadej's philosophy of "Sufficiency Economy", focusing on a balanced and moderate development strategy. The first stimulus package was more focused on low-income groups by distributing 2,000 baht per person to the low-income population. Included in the first package was "Training for the Unemployed Project" and the creation of a new curriculum in modern agriculture by the Ministry of Education. The package also allocated "sufficiency economy funds" to encourage people in the villages to improve their own economic efficiency and competitiveness. The second package was a continuation of the first one. It aimed at job creation, strengthening competitiveness, and improvement of core infrastructure to speed up the economic growth.

Boonyamanond and Punpuing also find that the poor were neither protected by any security system nor did they have access to social services or welfare supplied by the government. They show how population mobility has been used as a coping strategy during the 1997–98 crisis in Thailand.

In the Philippines, as discussed by Tigno in Chapter 9, a subsidy on the price of rice has been used as one form of a social safety net though rice is also a political commodity. The Philippines is a country depending very much on the global market for its domestic rice supply. By April 2008, the Government of the Philippines identified the poor in Metro Manila as needing access to subsidized rice to offset the difficulties they faced from the rapidly rising world price of rice. The government also issued family access cards (VACs) to identify those households that would be eligible.

In addition to the programme of subsidized rice, the government also started a cash transfer programme for families with children of schooling age

— the so-called Support Program for the Filipino Family. The programme was for the extremely poor households. There were three types of categories: a health and nutrition cash grant, an education cash grant, and an over-all household grant.

However, Tigno also shows that most of the recipients of social safety nets received their support in the form of food. Furthermore, most of them got help from relatives first, then from the government in the form of subsidized rice. Moreover, citing the World Bank, Tigno argues that support for the poor through subsidized prices is more a political agenda rather than a genuine programme to build household food security and reduce poverty. Therefore subsidies for rice should only be seen as a temporary policy. It is not a long term programme, due to the high costs of such a programme.

As elaborated by Chan in Chapter 10, coping mechanisms to access food were important to Cambodians in facing the rapidly rising price of food in the first half of 2008, especially in rural areas. Initially they chose cheaper foods or consumed a smaller quantity of food, particularly female adults and older persons. If they still needed money to buy food they would borrow from friends, relatives, or buy food on credit.

Sale of land and other assets was not a common coping mechanism. Most of them did not own land or other assets. They might sell their livestock, take a loan, or migrate to obtain cash.

Ling and Wong (Chapter 15) conducted a qualitative study on urban poverty in Sarawak, from January 2009 to June 2009. Sarawak has always been a higher cost-of-living state compared to Peninsular Malaysia. It is also one of the states with a relatively high rate of poverty. Others are Sabah, Trengganu and Kelantan among the east coast states, and Kedah and Perlis in the northern region of Peninsular Malaysia. However, Sarawak has been quite successful in reducing poverty over the last two decades. Measured poverty in Sarawak has declined from 21 per cent in 1990 to 4.2 per cent in 2007.

They find that the lower-income group among urban households consisted of those in the lowest-paid occupation groups, female-headed households, migrants from rural areas, and households with growing families and sick parents. Some people had fallen into very difficult circumstances because they were not eligible for assistance from the Welfare Department or other related agencies even though they really needed economic assistance.

For the main bread-winners of the family, the rising cost of living has forced them to work extra hours, often harming their own health. Health problems would worsen when there were inadequate health facilities in the surrounding areas or when the cost was too high. Some of them also had to

cut expenditures on their children's education, such as cutting back on tuition payments. This situation risks bringing those children into poverty.

Interestingly, they also found a positive impact from these economic miseries. Some have attempted to perform better in their workplace. Some changed their lifestyle, following cheaper and healthier lifestyles. Some stopped smoking. Others cut expenditure at pubs and increased the time spent with their families. Others switched to cheaper brands of products.

Ling and Wong then raise an important question — how social safety net programmes could help the lower-income groups during this period of rising living costs. They examine whether the existing social safety net programmes have been successful in protecting low-income groups from falling into poverty during difficult economic times. They conclude that some of the existing programmes were not designed to help those who fall into poverty because of rising costs of living. Some families did not know how to use the programmes. Others did not even know that the programmes existed, provided for in the state budget to cover welfare, medical, unemployment benefits, care centres, and subsidies to those in need.

They recommend the use of household income per capita to define the poverty line because the number of family members affects the purchasing power of the household. Currently, Malaysia as a whole and Sarawak use only household income as the criterion determining the poverty line.

Like most countries, Vietnam introduced a stimulus package to counter the impact of the global crisis. Anh (Chapter 14) shows how the government attempted to prevent low-income people from falling into poverty. It also tried to help the already-poor, with a cash assistance programme. Cash was granted to the grass roots communes shortly before the Tet (Lunar New Year) festivities in early 2009. Unfortunately, Anh concludes, the cash assistance did not reach the majority of the poor. On the contrary, some non-rich households enjoyed the cash.

In addition to the stimulus package, the government of Vietnam also introduced an unemployment insurance programme as of February 2009. It also increased the basic labour salary by 20 per cent.

Indonesia's experience with a social safety net programme is very interesting. Ananta and Arifin in Chapter 7 show that it did not exist during the 1966–98 authoritarian era, but poverty kept declining significantly. During this time, poverty alleviation programmes were incorporated in various ministries' development programmes.

The social safety net (JPS, Jaringan Pengaman Sosial) programme was initially meant to cope with the 1997–99 Asian crisis, when Indonesia was severely hit by the crisis, interrupting the declining trend of poverty. In 1998

various schemes were introduced such as a targeted rice subsidy, fellowships for education, aid for health services, and cash transfers. However, the social safety net programme has continued even after the economy rebounded after 1999. The programme is no longer aimed at helping those suffering from the crisis but now seeks to reduce relatively permanent poverty.

Ananta and Arifin further point out that the programme has been modified several times. Some schemes were successful and continued whilst others did not deliver satisfactory results. The latest initiative was the introduction of a conditional cash transfer (CCT) in 2008. The money was given to the mother, to be used for financing the health and education of her children and to pregnant/lactating mothers The CCT programme is expected to be continued until 2015, far beyond the recent global recession.

Though the poverty rate kept declining, even during the recent global crisis, it is still not easy to measure the contribution of the social safety net programme to the declining poverty rate relative to the contribution from the "usual" departmental programmes and relative to overall economic growth.

CONCLUDING REMARKS

It is beyond the reach of this book to cover questions of how to recover from the recent global financial crisis or which countries have been successful in their recoveries. What the book shows is how countries in Southeast Asia have been affected by the current recession, given limited currently available data, and how they were affected by the 1997–98 Asian financial crisis. Further, it has been able to review a sample of cases of how the poor have been affected by both crises. An underlying theme is that whatever the crisis, poverty commonly gets worse by adding new households to the headcount of the "poor" and by pushing some households deeper into poverty. Furthermore, it appears that with each recession, households are more readily and more quickly dropped into poverty than they are elevated above poverty lines when recoveries occur. In this sense, the poor in most countries bear a heavier relative burden from these crises and recessions than other groups.

The book also notes that doomsday scenarios were found in all these crises. For example, Ananta and Arifin (Chapter 7) show how there were very gloomy predictions on Indonesia's social, economic, and political condition during the 1997–98 crisis. This kind of alarmist scenario was produced by national and international elites, including the World Bank and the International Monetary Fund (IMF). The reality, however, was much better than expected. It was either the alarmist scenarios were exaggerated or policymakers responded well to the crisis and doomsday warnings. Whatever

the explanation, Southeast Asian countries recovered from the 1997–98 crisis and soon forgot the search for causes and remedies.

Now we are dealing with a new and much more globalized crisis which has hit Southeast Asia in a very heterogeneous manner. Those countries most hurt (for example, Cambodia, Thailand, and the Philippines) are still searching for appropriate responses to help their poor populations. What scholars and research institutions can do is to gather people from all disciplines to work closely to come up with proposals for successful strategies that take into account the diversity of poor populations and the differing economic circumstances, policies, and institutions across the different Southeast Asian countries. Nevertheless, dealing with a "new world architecture" is beyond their priority interests or capacities or both. Small and medium sized countries simply have to react to external economic circumstances with appropriate policies to rebound or escape from those negative circumstances.

A major conclusion of the book is the complexity of poverty and the difficulties in devising policies to deal with short-term needs, not to mention the long-term reduction in poverty. What governments in this region have mostly done is put in place policies that only buffer the impact of the crisis and then wait for the global storm to pass. As part of this complexity we see how different the poverty issues are among Southeast Asian countries. In countries with relatively lower per capita income, such as Cambodia and Laos, the issue of poverty still very much concerns those who are under the poverty line. In countries such as Indonesia, the development process has been successful in reducing the poverty rate, which is sometimes termed "consumption" poverty. The issue in Indonesia now is more on "non-consumption" poverty, such as undernourishment, high maternal mortality, and poor sanitation. Among countries with higher per capita incomes, such as Malaysia and Singapore, the issue is more on inequality among individuals (in Singapore) and among regions (within Malaysia).

The second conclusion is the need to give more attention to food security. This embraces food and agricultural pricing, commercial interests and price variability issues, as well as the interests of the poor. However, it is particularly important to deal with this issue because enhanced food security is so important in reducing poverty and preventing people from falling into poverty.

The third conclusion is the importance of internal population mobility as a coping mechanism during an economic crisis. Better means to move around in each of the countries implies a wider national labour market. A wider national labour market helps to enhance domestic economic integration in each country, in addition to helping those who suffer from the crisis. Fiscal stimulus and the removal of restrictive labour market regulations

can be used to enhance population mobility within each country, and hence it can help integrate better the domestic economy of each country. The relatively open migration policy within Indonesia may have contributed to its success in reducing poverty even through these several economic crises.

The fourth conclusion is the urgency of designing social security systems in Southeast Asia, for both coping with such crises and providing help to those who are poor even during "normal" economic times. This refers to those who cannot produce during normal economic times such as the elderly and disabled. Ramesh (Chapter 3) recommends that each of the governments in Southeast Asia create a strong social security system. This is needed to protect the needy and vulnerable groups, particularly during a crisis. Labour markets and families cannot be relied on entirely to provide the social safety net. Only the government, through its broad economic reach across rich and poor regions and its legal authority, can protect the needy and vulnerable groups across the country, especially during a deep recession.

Finally, poverty is still a continuing crisis in Southeast Asia. The world, and Southeast Asia in particular, may have recovered from the global crisis, but the poor still struggle to leave the poverty traps. Therefore, the rich communities should not forget that a segment of the people of Southeast Asia remain poor, often hit the hardest during any crises — crises usually produced by the rich.

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2

IMPACT OF WORLD RECESSION ON RURAL POVERTY AND FOOD SECURITY IN SOUTHEAST ASIA
Lessons from the 1997–98 Asian Crisis

Richard Barichello[1]

In the past two years the world economy has been hit by one of the most serious recessions in decades. One of the reasons this recession is particularly noteworthy is that it has followed very quickly on the heels of a strong and broad economic boom where growth rates were very high across a range of developing countries. This coincided with a boom in commodity prices, including not only oil and minerals but also food commodities. However, in the third quarter of 2008, the boom reversed into a rapid and equally broadly-based decline in economic activity across the globe, caused most directly by the seizing up of credit markets, and the financial sector more broadly. Simultaneously, commodity prices, again including food prices, declined even more sharply than they had risen.

What has been equally striking, from the perspective of mid-2010, is the apparently rapid recovery from this crisis. Real gross domestic product (GDP) in East Asia by then had risen to levels that correspond to those prior to the crisis. In fact the region has rebounded more quickly and is in stronger

economic shape than after the Asian Financial Crisis of 1997–98. The rapid rebound is heavily due to the influence of China in the East Asia aggregate, and when one examines individual country results the situation is more diverse. Thailand, Malaysia, and Cambodia, for example, had contracting economies in 2009. The average for all East Asia, including China, is 7 per cent for 2009, while excluding China gives an average growth of only 1.3 per cent.

Global food prices also rose and have remained high by recent standards. Although food prices generally fell after their spike in 2007–08, they rose again in 2009. Between January and December 2009, the World Bank's food benchmark index rose by 23 per cent. On an average calendar year basis, 2009 prices were lower than 2008 prices, but higher than 2007 prices. This was bad news for the net food-consuming poor in Southeast Asia, particularly as it coincided with the 2009 recession. Just like aggregate economic growth is quite variable by country, recent food price movements also varied by food group. Grains, fats and oils prices spiked between mid-2007 and mid-2008, whereas sugar prices spiked during 2009.

This rollercoaster of economic growth and increasing food prices along with a serious recession for much of Southeast Asia that not only lowered growth rates in all countries but lowered incomes in many, has serious implications for those in poverty. During the period of this recession we have observed a reversal of the gains in fighting poverty that had been achieved in the past decade. An important element of these lowered incomes is that this recession is having a negative impact on food security. Although this is only one aspect of poverty, it is particularly relevant because food accounts for such a large share of poor families' expenditures. In addition, it is especially important for future income-earning opportunities due to the effects of food insecurity and resulting nutritional deficiencies on those most vulnerable — children and women.

It is the purpose of this chapter to anticipate and better understand the likely effects of the 2008–09 recession on poverty levels, in particular on the rural poor. It will do this on the basis of what we have learned from efforts to alleviate poverty over the last several decades and draw on a parallel financial crisis and recession experienced in Southeast Asia just more than a decade ago, the Asian financial crisis of 1997–98. It will raise the question of whether this recession will leave the rural poor less affected or even isolated from the downturn, which is most highly manifested in the manufacturing, trade, and financial sectors. It will also examine the likely effects of this recession and related developments on several aspects of food security. To conclude, it will consider policy options that may be most helpful for the rural poor, considering both the loss of incomes and

increased food insecurity. In doing so, it will attempt to bring out lessons learned from the Asian financial crisis.

DIMENSIONS OF CURRENT GLOBAL FINANCIAL CRISIS

This recession has hit developed countries hardest, and the first quarter forecasts for 2009 were for negative growth in virtually all countries in North America, Europe, and the developed countries of East Asia. Counter to earlier predictions, developing countries were *not* likely to be immune to the crisis. Among them, China's and India's prospects were the best, declining to 6 and 5 per cent, respectively, for real GDP growth in 2009. Among Southeast Asian countries, early 2009 forecasts in percentage GDP growth terms were pessimistic: Indonesia 1.9, Malaysia –0.3, Singapore –7.5, Thailand –4.4. Put in per capita terms, even Indonesia would experience zero growth at best.

These forecasts represented a significant reduction in growth, if not outright recession, compared to the two previous years, and forecasts were continuously being lowered from the third quarter of 2008 through the first quarter of 2009. The March 2009 forecast by the International Monetary Fund (IMF) was for the world economy in total to decline in 2009, the first year that has happened since World War II (World Bank 2009). To early 2009 there had been a significant decline in trade, leading the IMF to predict for 2009 the first annual decline in world trade since 1982, and the largest decline in eighty years. Capital and credit flows, remittances, aid, and most natural resource and commodity prices were all expected to fall. The latter would burden most heavily resource sellers and net food exporters, but the substantial (and seemingly increased) volatility of all these economic variables was a curse to all countries ("Toxins Trickle" 2009, p. 62) Although 2010 was expected to show a return to positive growth for most countries, the forecast growth rates were anemic by recent standards, especially for Asia.

With all key economic variables declining, from exports, foreign aid and government budget revenues to foreign workers' remittances and domestic jobs, developing countries were expected to see considerable increases in poverty, likely falling most heavily on countries and sectors heavily associated with international trade. Martin Ravallion of the World Bank predicted that 65 million people worldwide would fall below the US$2 per day measure of poverty, an increase of 12 million from the forecast of only one month earlier ("Toxins Trickle" 2009), and a serious offset to the poverty reduction gains of the last decade.

By the first quarter of 2010, the dimensions of this recession were known more clearly. For a variety of reasons that lie beyond this chapter, the region had escaped many of the serious difficulties that were experienced at the time of the 1997–98 Asian financial crisis (World Bank 2010, p. 5, Table 1). For example, excluding China, real GDP in the developing countries of East Asia contracted 0.6 per cent in the first half of 2009, but recovered to record positive growth of 1.3 per cent for the year as a whole. This can be compared with a contraction of 8 per cent in 1998 among the same countries. All other variables examined (e.g., exports, real exchange rates, public debt, non-performing loans) show the same result, that the 2009 recession was less severe and shorter in duration than the 1997–98 crisis within East Asia.

However, the impact of the current recession on poverty and its reduction is likely to be different. Changes in poverty occur much more slowly than do financial magnitudes, and the kind of disaggregated income data needed to reveal poverty changes are also slow in coming. So we must rely on model simulations and ad hoc or anecdotal observations to learn quickly of the effects of this recession within the region. We know that the recession has hit export jobs and increased unemployment most in trade-sensitive sectors and countries. This has typically shifted workers from higher-paying into lower-paying jobs, from the formal sector, into the informal sector and back into the agricultural sector. This is exactly the reverse of the poverty-reducing effect that had been observed in earlier decades when strong non-agricultural-sector growth shifted labour via migration and local mobility from low-paying agricultural jobs to higher-paying off-farm jobs, rural and urban. Therefore it is almost certain that poverty has increased in those countries that are experiencing recession (e.g., Cambodia, the Philippines, Thailand, and Malaysia). This kind of poverty increase will occur even if there is no increase in measured unemployment, because these income losses occur among the employed. World Bank estimates, and observations, are entirely consistent with the process just described. In the World Bank category of "Developing Country, East Asia",[2] the increase in poverty is estimated at 14 million in 2010, and in the Philippines, the increase in poverty is estimated at 2 percentage points (World Bank 2010). These aggregate data are also consistent with various local observations.

> In Cambodia, job losses in the higher paying manufacturing, construction and tourism companies led people to seek work in the lower paying agricultural sector. In Malaysia, the loss of manufacturing jobs early in the year led to job increases in retail trade and public services, where wage rates are lower. Those suffering most are unskilled laborers that typically toil in the informal market or are engaged in subsistence agriculture. The crisis did not leave them idle, but with the ranks of the informally

> employed swelled by some of those that lost jobs in the formal sector, their earnings fell substantially.… In Cambodia, for example, low-wage garment- and construction-sector workers were particularly hard hit by the slowdown. Those who retained their jobs in these sectors saw their hourly wage rates cut by as much as one-third. (World Bank 2010, pp. 12–13)

What makes this 2009–10 increase in poverty sobering is that a return of workers to their old jobs is typically a slow process. Even when new jobs are created, the processes of search and migration take time. These lags will extend the period over which lower incomes are received, making the rebound from poverty considerably longer than the rebound in GDP. As a result, the optimism that is now observed in the commercial and financial sectors over the rebound in economic activity that has recently occurred in East Asia, however erratically across countries, is not justified in terms of a rebound in poverty reduction. Put differently, the concerns and pessimism surrounding poverty reduction in East Asia in early 2009 are still relevant in 2010 and over the next few years.

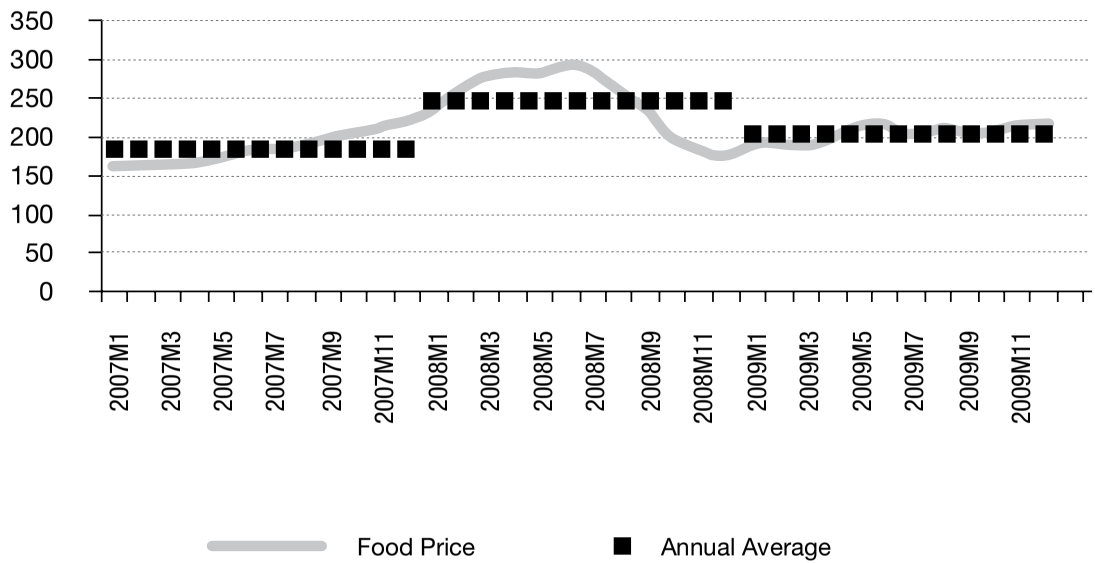
This current poverty situation is exacerbated by recent food price patterns. Food prices are an important element of poverty because most of the poor, even in rural areas, are net food consumers. From 2000 food prices roughly doubled to the levels of 2007–09. Prices in 2008 peaked at 2.5 times the level of 2000, but even in 2009 those prices are more than double 2000 levels. These patterns are illustrated in Figure 2.1 below. Further, the overall pattern of declining food prices which have helped poor people from at least the 1960s to the early 2000s appears to have ended, at least for a decade. All of this is to suggest that food security as an important element of poverty has unequivocally worsened with the current recession and is not short term.

KEY ISSUES FOR URBAN AND RURAL POVERTY

As governments and multilateral organizations continue to respond to the 2008–09 economic crisis, it is important to understand the process of poverty reduction. This is needed to know which policy measures are most important for limiting increases in poverty, and which measures will exacerbate them. To this end we start by reviewing the factors that have been observed over the past few decades to be successful in reducing poverty, both urban and rural.

Most clearly, economic growth is one of the strongest and most direct mechanisms for pulling families out of poverty. This conclusion is reached in almost all studies, with the caveat that this process is stronger in some

FIGURE 2.1
Trends in Global Food Prices



Notes: (1) 2000=100; (2) Annual averages refer to the average of the food price index for the calendar year.
Source: World Bank, DEC-PG (Food Price Watch), 2010 <http://siteresources.worldbank.org/INTPOVERTY/Resources/335642-1210859591030/FINAL_Food_Price_Watch_Feb2010.pdf>.

countries and circumstances. To cover these differences, the term pro-poor growth is often used to emphasize the characteristics of growth-enhancing policies that are more likely to bring households out of poverty. Encouraging rural economic activities, especially agriculture, is often mentioned as one of these characteristics. In numerical terms, for countries with average (e.g., below 2 per cent) levels of population growth, it is often argued that real economic growth rates above 5 per cent are needed to make much of a difference in reducing poverty, and by 8 per cent this poverty reduction effect is substantial. Indonesia's experience in the period from 1970 to the Asian financial crisis and China's experience since the early 1980s bear this out quite clearly.

Another aspect of strong economic growth that reduces poverty is job or earnings creation. Greater employment creation and reduction of unemployment lift more households out of poverty, especially when the new jobs involve higher-than-average wage rates. Growth in an environment where many firms are labour-intensive results in more job creation, and this is argued to occur more readily among small and medium-sized enterprises. Therefore, strong growth in such a structural environment of labour-intensive firms is also an effective component of successful poverty alleviation strategies (Lanjouw and Lanjouw 2001).

Another macroeconomic variable that is often associated with poverty reduction is trade. From economic theory there is a strong presumption that in the long run trade reduces poverty. This could be seen as just one of many underlying factors influencing overall economic growth rates, but it has been examined quite thoroughly to show the ties between poverty and trade, with arguments that at least in the short run, say less than two to four years, trade has an adverse effect on poverty. The empirical evidence is reviewed in Winters, McCulloch and McKay (2004) who note that it broadly supports the longer run positive effect of trade on poverty alleviation. However, the outcome does depend on a number of country-specific factors related to the types of trade reforms undertaken and the circumstances of the poor. They conclude that "with care, trade liberalization can be an important component of a pro-poor development strategy". We also observe with the current recession that the benefits of trade when a country opens to trade or increases its trade are reversed when trade declines or when borders are closed to trade. In other words, a country that opens up to trade enjoys more rapid growth in incomes and poverty reduction, but with more variability in incomes as global economic conditions fluctuate.

If one wishes to focus on a major economic contraction, like the one we just faced, there are also distribution effects that can have a major impact on poverty. Recessions by their nature will reduce demand more for those

goods whose demands are income-elastic. Given that a large number of the poor work in local service sectors and in agriculture, both of which produce outputs whose demand is considered income inelastic, those individuals and households are likely to be hurt less than average by job losses, unemployment, and income declines. This is the source of the oft-made argument that a recession will hurt rural areas less than urban areas, and that the rural poor will be relatively isolated from aggregate economic contractions.

The last major topic of macro interest that we will address is that of migration. The movement of labour from jobs of low productivity and wage rates to those with higher productivity and wage rates is always a source of economic growth at the macro level and increased personal incomes at the micro level. As such it is a potential pathway out of poverty. Its importance is often claimed, not only in simple regional terms, but also in sector terms, notably in the shift of labour from agriculture to the non-farm sector. Among the rural and agricultural poor, the prospects for moving out of poverty through migration is well studied and somewhat complex. If one allows for a ladder of migration, from farm to rural off-farm jobs in the village, from local village jobs to jobs in regional urban centres, and from regional centres to large urban centres; if there is a reasonable level of integration across these geographical regions, possibly facilitated by some infrastructure; and if rural migrants have sufficient human capital to compete for the village/urban jobs then migration appears to be a very successful route out of poverty for all groups. Within Southeast Asian countries, these conditions are often met.

Finally, there are a host of microeconomic factors that are important to moving out of poverty. Many of these are characteristics that individuals and families can acquire, although they can also be provided on a macro scale by central and regional governments. The most widely obvious characteristic to acquire to move out of poverty, as touched on above, is education. A related human capital investment that is helpful in moving people out of poverty is health. A high proportion of papers in the poverty alleviation literature emphasize the importance of human capital as a successful pathway out of poverty and that an investment in education be made as part of public policy to alleviate poverty. In addition, age and sex have a strong influence, and household size and the number of young children have a negative effect on movement out of poverty (McCulloch, Weisbrod, and Timmer 2007).

It is widely acknowledged that the main pathway for the rural poor to leave poverty is to increase their productivity. Given that the rural poor heavily dominate the numbers below the poverty line in the low-income tier of developing countries, and that most of them are primarily engaged in low-productivity agricultural production, one important method of reducing

poverty includes increasing agricultural productivity. However, this increase in productivity can also come about through improved productivity in rural non-farm enterprises and through migration from rural to urban areas. An excellent review of this literature is found in McCulloch et al. (2007), a paper that assesses the movement out of poverty for rural Indonesia. Work in this area has focused on the role of agriculture in economic development and poverty reduction, and the linkages between agriculture and overall economic growth, going back at least to the mid-1950s.

There are two themes in this literature that are sometimes portrayed as being competing hypotheses. One theme emphasizes the importance of increasing agricultural productivity and that this has the strongest anti-poverty effect. The other argues that non-farm enterprises are the engines of rural growth and poverty reduction. Clearly investments in the two sectors are complementary. The potential of investing in agricultural productivity is well documented, as are the positive effects these investments will have if the sector is labour intensive and if land holdings are not too concentrated.

However, there is also abundant evidence that growth in the non-farm sector, whether it is rural or urban, is often considerably faster than in the agricultural sector. Large social gains from transferring labour out of the agricultural sector to the non-farm manufacturing sector are common, and the higher wage rates in the non-farm sector attract many rural migrants. In fact, evidence from Vietnam and China suggests that even if agricultural GDP grows at more than 4 per cent, which is exemplary performance from this sector, wage differentials between rural and urban areas cannot be narrowed unless there is relatively open migration to allow rural residents to share in rising urban wage rates. The success of Indonesia in reducing rural poverty is noteworthy, consciously giving policy support to agriculture and encouraging strong non-farm growth with substantial rural-urban migration. What is often forgotten is that rural-urban migration also raises labour productivity and wage rates in the rural sector (Larson and Mundlak 1997).

EFFECTS OF THE CURRENT GLOBAL CRISIS ON RURAL POVERTY

There appears little question that the current recession will increase poverty in almost all countries. Just as rapid economic growth can be remarkably successful in reducing poverty, a decline in growth of the scale we have observed, even if it covers only a couple of years, will stop reducing poverty and, in cases where growth turns negative, will be most likely to increase it. But the question that is less obvious is how this will affect rural poverty.

To examine the effects on poverty, rural or otherwise, we must observe the effects on the wage rate. Many policies and situations may result in strong effects on land values, but that will hardly affect the poor. By definition, the poor own few assets, including land. Put differently, the term, poor landowners, is an oxymoron. So policies that largely raise land values and not wage rates will have little effect on poverty.

There are some observations that can be made on the basis of the research we have reviewed. Agricultural productivity growth when adopted by smallholders reduces poverty. But the recession is not likely to have a major effect on agricultural productivity. This variable increases with improvements in agricultural technology or know-how, as a result of research, extension, and education. It can also be enhanced by improved infrastructure. These variables can be changed only in the intermediate to long run, and none of them will have changed in the short-run circumstances of a recession. The only shorter-run effect may be a reduction in the use of some inputs, such as fertilizer, due to credit constraints. This may be a factor, but fertilizer use among poor farmers is not usually that high in any case.

Could there be a decline in poor farmers' incomes due to declines in agricultural prices? They could fall in the recession, but this is not so certain. In fact, because food is largely a necessity, at least for most cereals, other field crops, and vegetables, the decline in demand due to the recession can be expected to be modest. More importantly, there was some decline in agricultural prices in 2008 following the rapid increase in 2006–07. Those prices fell only to their longer-run trend level, and further declines are not likely. Indeed, 2009 prices increased. Will developing country governments act to push farm prices lower, such as by reducing subsidies, lowering tariffs, or removing non-tariff barriers? Again, such a reaction to the recession is not so likely. Budget pressures may result in the reduction of some subsidies, but few developing country governments finance farm price subsidies. The more likely impact on farm incomes will come from possible increases in the cost of credit. This is likely to affect mostly larger and less poor farmers. In sum, it is not that likely that farm prices or incomes will fall significantly even if this was a very extended recession.

Even if farm prices or input costs were to decline significantly, the question is whether this will affect farm wage rates, or it will largely affect land values. This is an empirical question that is likely to differ by country. However, in countries with a substantial population density, close proximity between rural and urban areas, and high rates of rural-urban migration, with the agricultural sector accounting for a modest proportion of GDP, such as roughly no more than 25 per cent, it is likely that rural wage rates depend substantially on the

urban labour market, not on the farm demand for labour. When this is the case, such as is very plausible for Indonesia, Malaysia, and Thailand, changes in farm prices and profitability will affect mostly land prices, not wage rates. In such environments, the recession is likely to have little effect on the poor via agricultural productivity or profitability.

To examine the likely effect of the recession on rural wage rates we must look more seriously at the non-farm sector where rural people supplement their income via off-farm employment by farmers and farm family members, and where those who migrate obtain their wages. Here the effect of the recession will be felt more directly and possibly significantly. The more interconnected the rural and urban labour markets, the more significant will be the recession in pushing rural people, including those in agriculture, into lower wage rates, lower income levels, and increased poverty. It would be our judgment that the current recession will have its largest effect by far on rural wage rates through reduced employment in the non-farm sector in most Southeast Asian countries.

Just as credit markets are likely to connect rural and farm families with the difficulties being felt in many parts of the urban/industrial sector due to higher interest rates, reductions in jobs and declines in incomes in the urban labour market are also likely to be translated into lower wage rates, fewer jobs, and lower incomes for poor rural and farm families. The conclusion here is that with the possible exception of the lowest-income Southeast Asian countries, such as Cambodia, Laos, Myanmar, and possibly Vietnam, where rural labour markets may not be as well integrated with urban labour markets, the rural poor will not escape the negative effects of the recession. They may be slightly less vulnerable due to the relative stability of agricultural prices and demand, but their reliance on the usually-beneficial urban and rural non-farm labour market will hurt them in this recession. We now have observed some or all of these effects across much of Southeast Asia and even in China where the recession has been most modest and brief (World Bank, 2010, pp. 12–13). If food commodity prices continue to rise as they have in 2009, the net food-consuming rural poor will not escape from increased poverty in this recession; they will have no place to hide.

LESSONS FROM THE ASIAN FINANCIAL CRISIS

Much has been written about the effects of the Asian financial crisis, and many of its features parallel the current crisis. The current recession appears to be shorter and less damaging to most Asian countries, but many features are similar. One component of a financial crisis that has not been mentioned

to this point is the relevance of currency depreciation. This was a much more significant factor in 1997–98 in Thailand and Indonesia, where the result of large depreciations in those currencies was an increase in traded goods prices, helping farmers considerably. Overall income declines in that episode may have been larger than were experienced in the current recession, especially for Vietnam and Indonesia, but there are sufficient similarities that a summary of that experience on rural poverty is valuable.

The first result was that the large price increase of agricultural products from the currency depreciation cushioned the other negative effects of the crisis. Given the more modest change in exchange rates in the current crisis, this factor cannot be counted on to such a significant degree. In Indonesia, the labour-intensive agricultural sector was successful in absorbing the return migrants, whereas this did not happen in Thailand (Gragnolati 2001). The effect of this was that poor farmers in Thailand bore the brunt of the crisis due to their reliance on the urban economy for incomes compared to Indonesia (Bresciani et al. 2002). They stated, "small and landless farmers derive most of their income form off-farm sources rather than their own cultivation". They also noted there was no evidence of a rural credit crunch.

At the Twenty-fifth FAO (Food and Agriculture Organization) Regional Conference for Asia and the Pacific (FAO 2000) the importance of the non-farm economy over the agricultural sector was stressed. It was noted it was difficult for the agricultural sector to absorb the large number of displaced workers, and wage rates fell. Remittances of migrant family members also fell to reduce incomes of the poor. Any supply response from agriculture was limited by the higher interest rates and credit squeeze. It was also argued that most of the rural poor are net consumers of food, making the increase in food prices an important factor in increasing poverty.

Two studies tended to be more positive about the effects of the 1997–98 crisis on the poor. Suryahadi et al. (2003) noted that a large proportion (40 per cent) of households went into poverty with the crisis but came out afterward. This compared with 42 per cent who did not become poor and 18 per cent who were always poor. Newhouse (2005) noted that although 30 per cent of the household income decline remained after four years, the crisis did not disproportionately affect poor households.

In one of the studies most focused on the short-run effects of such a macroeconomic crisis on poverty, Ravallion and Lokshin (2007) conclude that the 1997–98 crisis had a large short term impact on poverty. The aggregate poverty rate trebled at the peak of the crisis. Although there was a sharp rebound in incomes, four years later one quarter of the 262 districts in Indonesia had poverty rates that were doubled due to the crisis. These

estimates were calculated based on the counterfactual question of what would have happened without the crisis. They also found that those districts that were initially poorer (and had higher income inequality) suffered lower proportionate impacts due to less integration with the rest of the national economy and lower pre-crisis income levels. Their conclusion is most interesting and likely relevant today: "our results offer no support for the (seemingly common) view that greater poverty comes hand in hand with greater vulnerability to an economy-wide crisis" (p. 54).

To summarize with application to the current situation, it would seem that the Asian financial crisis has much relevance. Poverty is likely to increase, and the main reason is the decline in non-farm/urban incomes that the poor rely upon so significantly. Agricultural incomes are unlikely to increase as much in the current recession compared to 1997–98 due to the much-smaller currency depreciations taking place this time, but even if they did, they would not compensate for the large non-farm income losses that will occur, due to the high proportion of the total income of the poorest classes accounted for by non-farm incomes. Finally, on the basis of Indonesian data and experience in 1997–98, it is likely that income declines of the poor will be somewhat less than proportionate to the average income decline, due to the poorest groups living in more isolated regions and those that are less well integrated with the non-farm economy. These are not particularly positive results — after all, poverty is expected to increase in a recession — but they show there is no reason to be overly pessimistic either.

EFFECTS ON FOOD SECURITY

Food security is most commonly defined as access to food, sometimes including attention both to availability on the supply side and accessibility on the demand side. The issue of availability is rarely an issue on world markets, as long as you can afford the price. But affordability is often an issue for poor people, hence the desirability of raising the topic of food security in a discussion of poverty. This is all the more true when one considers that food is a critical input for energy to work and do household tasks, for protein and micronutrients to ensure growth and development, particularly for children, and for all people to have the nutrients to stay healthy. As Sen (1981) has pointed out, food security for the poor requires buying power, affordable prices, and for the very poor, access to transfers that may substitute for a lack of income in achieving the necessary buying power. Tweeten (1999) argues convincingly that accessibility is the major constraint to food security. This is underlined by the facts that most food-

insecure people live in rural areas and most of them are net food consumers. His statement that "increasing productivity and real incomes of food-insecure people remains the principal route to food security" (p. 475) sounds like a statement from the previous section of this chapter on the essential means of alleviating poverty. Indeed, Tweeten goes on to say that "alleviating food insecurity means alleviating poverty".

There are many definitions of food security. The USAID definition (United States Agency for International Development 1992, p. 1) is "when all people at all times have both physical and economic access to sufficient food to meet their dietary needs for a productive and healthy life". A different definition is food self-sufficiency, emphasizing the importance of achieving domestic or regional production to obtain food security. A feature of this definition is that it places farmers at the centre, particularly those who are net sellers of food, but often its achievement means raising food prices. Other definitions are more detailed and based on specific nutrient (e.g., protein, calories, or micronutrient) access and availability.

The measure of food security which I believe captures its essence and which is operational, i.e., allows ready calculation, is the family's budget share spent on food, meaning the ratio of food expenditures to a family's budget or income. This ratio is also called the Engel coefficient. With this definition, food security is achieved by keeping this food expenditure share of family income below some critical percentage. Among its advantages, it allows examination of factors affecting the numerator separately from those affecting the denominator. For example, a rise in food prices, for reasons of cyclical market price movements like we observed in the 2006–08 period or a country's national policy, will raise the numerator and lower food security. A decline in the long run (trend) price of food will lower the numerator and increase food security. Alternatively, an increase in income of a country, region, or household will increase the denominator, raising food security. As with the Asian financial crisis, the current crisis for many countries, by lowering the denominator, will reduce food security.

With this measure the focus is on consumers and shortfalls in food consumption, not primarily on farmers (like food self-sufficiency). It allows any level of aggregation. It can be calculated at the national level to give a measure of food security for a country at a point in time. It could also be calculated for an individual family also at a point in time. Each level of aggregation would provide different information and be useful: food security problems arise at the household level, but policies are usually formed at the national level. Another feature of the Engel coefficient is that it is relatively straightforward to obtain the data to calculate it. Some might prefer this

coefficient be calculated at the nutrient level, and this could be done. Similarly it could be calculated for individual foods or commodities. But for this chapter we will focus on the relatively simple version covering expenditures on all foods, as described above.

It is worth comparing the use of the Engel coefficient with food self-sufficiency to see further the advantages of the former. Government policy measures to increase food self-sufficiency, particularly in developing countries, are often trade barriers. These limit the access of lower-cost imports, raising domestic prices and in turn increasing domestic production. By both limiting imports and increasing domestic production, the food self-sufficiency ratio is clearly increased. By this measure, food security is increased. But note the effect on food affordability and accessibility for poor people. With the increase in food prices that often accompanies most measures to increase food self-sufficiency, food becomes less affordable and accessible to the poor. By contrast, the Engel coefficient captures this. The numerator would increase, raising the ratio to indicate less, not more food security.

A more striking example concerns the food price increases that occurred in 2006–08. In this period food prices rose for most cereals, prompting a food "crisis", with food riots in many countries. This was a serious enough political issue that a number of food exporting countries, almost thirty in fact, decided to restrict or stop exports. With the rise in prices starting in 2006 for corn there was enough time for a limited supply response. This would be captured as an increase in the food self-sufficiency ratio. In the event that some countries reduced imports due to their dramatic rise in price or the increased difficulty in accessing supplies (from the export bans in rice, for example), the self-sufficiency ratio could have increased further. At the very least this ratio would not have fallen. Using this measure, food security improved, or at least did not deteriorate. The Engel coefficient, in contrast, would have increased sharply with the dramatic increase in food prices that was not matched in any country by comparable income growth. So this measure would show a large decline in food security. Judging by the political crisis and riots from rising food prices, this food price increase is clearly a case of reduced food security and this is captured by the Engel coefficient, not by the self-sufficiency ratio.

What is the effect of the current recession on food security? For those countries that experience negative economic growth, which is likely to include many countries of Southeast Asia, this fact alone will reduce food security. However, the numerator of the Engel coefficient should also be considered. Food prices have fallen from their peak back towards what was their long-run trend line, which was downward. However, they have stabilized and in 2009

have increased again. A long-term downward sloping trend line calculated with data prior to 2006 may not be a good guide to the intermediate-term future. Two factors have pressed food prices upward and those factors are not likely to have significantly changed over some intermediate-term time frame. One is the array of (inefficient) subsidies to use food crops for fuels. This is widely judged to be a very important component (e.g., by several credible estimates, roughly one third) of the large rise in food prices that occurred. High energy prices add further upward pressure on food prices. In addition, another factor that is important is the steady increase in demand, at least for better quality cereals and foods rich in protein such as meat, fish, and milk products, from many poorer countries. This increased demand is coming heavily from China and India. Given the inelastic supplies of land this would appear to generate continued growth in food prices, although new technologies such as genetically modified food production could supply some of the increased demand.

In summary, it is not likely that food prices will be falling in the intermediate term and they have risen in the short term, yet incomes have fallen or not increased in many countries in Southeast Asia. The most positive case in the region would likely be Indonesia, due to still-rising incomes during this recession. However, to preserve its current level of food security, no policy moves to raise food prices (especially rice) should be undertaken. With allowance for some variability across countries, the likelihood is that food security across the region has worsened. This may seem like just another manifestation of increased poverty from the recession, but the food security picture is more cloudy as discussed, due to the uncertainties about future supplies of food and hence its prices.

CURRENT PROSPECTS FOR POVERTY IN THE REGION

Drawing from anecdotal observations and a recent World Bank overview (World Bank 2010), we summarize the current prospects for poverty across a sample of four countries within the region (Cambodia, Indonesia, Thailand, and Vietnam). From this sample it is clear that there is considerable heterogeneity in the country poverty situations within the region following from the current 2008–09 recession. Of these four countries, Indonesia and Vietnam are bright spots where the impact of the recession has been minimal, whereas in Cambodia and Thailand the situation is much more difficult. The prediction of increased poverty, at least for the short to intermediate term, is quite clearly borne out in those two countries. These conclusions are drawn from a mix of aggregate growth, export, and wage index data,

complemented by survey and anecdotal evidence of firms and migratory shifts back to rural areas.

What makes the poverty situation more serious is the increase in food and fuel prices over the period. Food security has almost certainly worsened due to the increase in food prices during 2007–09, and those prices are unlikely to fall to previous levels, at least within the next decade. The appropriate and clear intermediate-term antidote to rising food prices is increased wage rates and employment growth from overall economic growth. Yet in this recession, at least for countries like Cambodia and Thailand, that option has been lost or compromised. So at least within the period of this recession and looking forward in the short term, the rural poor who are net food consumers are likely to be worse off and suffering the kind of increased poverty that their urban compatriots have endured during this recession.

Cambodia

The recession has hurt Cambodia substantially, notably in 2009. It suffered a 2 per cent decline in GDP, total goods exports fell by 17 per cent (garments alone by 16 per cent), tourism receipts were down by 2 per cent, and direct foreign investment fell by 35 per cent. These external factors were compounded by similar negative domestic effects, especially in much reduced construction and in higher interest rates. A survey of 400 firms showed a 30 per cent decline in sales and profits in mid-2009 compared to 2008. Eight per cent of these firms went bankrupt or otherwise closed operations. Agriculture continued to grow at a robust 5 per cent. Indications are, however, that by late 2009, the economy was turning around. Agribusiness exports (primarily milled rice and rubber) more than doubled and most other indicators either stabilized or showed some growth. The result is a forecast growth rate for 2010 of 4 per cent.

But the two factors of the early 2008 spike in food prices and the overall economic slowdown of 2009 had a clearly negative effect on low-income populations. Only a fifth of all households work in the three most affected industries — garments, construction, and tourism — mostly urban households, but the effect on rural and poorer households will be greater in relative terms on their household income. There is evidence that these households had to shift to more job activities, including moving back to the agricultural sector in order to reduce the impact of lost jobs and lower incomes. Measured poverty would almost certainly have increased, particularly in rural areas, due to the influx of return migrants pushing down wage rates and the decline in remitted urban incomes.

Indonesia

Among Asian countries only China fared better during this recession than did Indonesia. It was the brightest spot among Southeast Asian countries, and from 2008 to 2009 GDP only fell from 6.0 to 4.6 per cent. This is due to a combination of increased government spending, a relatively small external sector (exports account for about a quarter of GDP) where exports did fall (by 14 per cent), and sustained strength in consumer spending and industrial production. From late in 2009 exports are rebounding rapidly, but there is some evidence that consumer spending will be less strong in 2010, leading to a forecasted modest increase in aggregate growth to 5.6 per cent. This picture of Indonesia mostly escaping the effects of the worldwide recession suggests largely flat real wages and no clear increase in poverty in 2009 and 2010.

Thailand

Given the highly open and export-oriented nature of Thailand's economy (the ratio of exports to GDP has been 60 per cent over the last four years), the country was quite negatively affected by the recession. GDP fell by 2.3 per cent in 2009, although this masks the depth of the decline that began in late 2008 and the strong rebound in economic activity in the fourth quarter of 2009. The result was that GDP at the end of 2009 had returned to pre-crisis levels. One year of growth had been lost but the economy had recovered from the recession. Outside the external demand sector (manufacturing and tourism), growth has been relatively modest, consumption fell in 2009, and a severe drought has reduced agricultural output and incomes for 2010.

The overall outlook for poverty is mixed. It has almost certainly increased from 2008 to 2009 due especially to the reduction in purchasing power from higher food and fuel prices in 2008. Although overall wage rates will likely increase in 2010, this is offset by the number of lower income workers who returned in 2009 to low-productivity agricultural jobs due to the urban job losses of the recession. As more jobs return from the rebound in external demand in 2010, rural to urban migration should resume and begin the process of reducing poverty, subject to questions about political uncertainty.

Vietnam

Despite its even higher ratio of exports to GDP (65 per cent over the last five years), Vietnam survived the current crisis in very good shape. Real GDP growth in 2009 fell only from 6.2 to 5.3 per cent, partly due to a large government stimulus programme and in spite of a decline of 10 per cent

in exports. Despite a number of macroeconomic challenges, the economy appears to be continuing its strength in 2010 and there appear to be no likely increases in poverty, at least if inflation can be held to reasonable levels.

POLICY OPTIONS: LESSONS FROM THE PAST

With the mixed effects over time and across countries from this current recession and its negative effects on poverty and food security, what policy decisions could be undertaken to minimize the impact on poverty, particularly rural poverty, and to prevent any serious decline in food security?

First, employment growth in the non-farm sector is such an important factor in reducing poverty, including rural poverty, that reigniting aggregate economic growth is a high priority. Most countries in Southeast Asia do not restrict migration from rural to urban areas, but obviously any such restrictions will increase rural poverty and are to be discouraged. Some authors go further and argue that greater encouragement should be given to out-migration from agriculture areas to jobs in more urban environments, although Indonesia appears to be a case where migration flows between rural and urban areas are already substantial with no special encouragement. The importance of non-farm employment suggests that any policy measures to improve access and information flows between rural and urban areas, such as rural infrastructure, also will facilitate the shift of employment out of agriculture and into higher paying jobs. The work of McCulloch et al. (2007) suggests that economic growth in smaller towns in rural areas to promote job creation outside the major urban centres will be of particular value to poor farm families because their exit from agriculture is first via non-agricultural jobs in the nearby rural areas. All job seeking in the non-farm sector, especially within larger urban centres, is made much more successful if the rural migrant has a competitive level of education. McCulloch et al. show that higher-educated individuals among the poor achieve the most rapid income growth, by allowing them to engage in higher-productivity activities and to achieve a higher probability of obtaining a job when they migrate out of the region or out of the agricultural sector.

In addition, many of the poor in agriculture escape poverty and remain working in agriculture. To what extent this involves off-farm employment and what is the split in income between farm and non-farm work is not made clear. But judging by broader patterns of income composition as a function of income from around the world, the escape from poverty of those still working in agriculture is accomplished heavily on the back of off-farm employment. Still, incomes are increased among agricultural workers when their productivity is raised. McCulloch et al. go so far as to claim this

is the principal pathway out of rural poverty. This can be accomplished by increased spending on agricultural research, agricultural extension and training, and rural infrastructure, and by doing so facilitate access to and the use of more modern technologies. It goes without saying that the first policy recommendation should be not to discriminate against farmers by taxing their products, imposing export taxes and bans, adopting an overvalued exchange rate, denying them migration rights, or by failing to provide infrastructure, education, and health services comparable to those found in other regions.

Almost all these policy recommendations come from what Tweeten (1999) calls the "standard" model of economic development. They certainly are long term recommendations involving investments that take time to produce and even longer to bear returns. As such they offer cold comfort to those individuals — or their households — who find themselves out of work or with reduced incomes in the current recession. The most urgent priorities to help the poor at this time appear to be equivalent to the general priorities for moving developing countries out of the current recession. At a very aggregate level, these are restoring confidence, restoring aggregate demand, increasing concessional aid flows (enhancing the counter-cyclical impact of lending from the International Monetary Fund and parallel financing from the multilateral development banks, and providing additional support to the private sector, particularly in emerging markets (World Bank 2009, pp. 16–17). The only quick-acting measures that would help the poor directly would be those that increase demand by targeting support directly to poor people, when such programmes exist. However, in restoring aggregate demand, mostly through government expenditures, there are many options to choose from, injecting funds into projects and areas described in this section. Even if the returns are not immediate, failure to make these investments will delay even further the benefits to those in poverty.

Notes

1. I would like to thank Faisal Harahap and Adam Soliman for their helpful research assistance in the preparation of this chapter.
2. The World Bank's "Developing Country, East Asia" category includes those in Southeast Asia.

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3

GLOBAL ECONOMIC CRISIS AND SOCIAL SECURITY IN SOUTHEAST ASIA

M. Ramesh

The following summary of the origins of the 1997 crisis in Asia has eerie echoes of the start of the current crisis in the United States:

> The lead up to the crisis involved growing private capital flows … encouraged in part by the prevailing low interest rates.… In many instances governments had recently liberalized financial institutions, although without building up a sufficiently strong financial supervisory and regulatory capacity. These poorly regulated financial institutions took on excessive external debt … stimulating a surge in domestic credit, investment and asset prices. Strong asset prices and growth in turn attracted more foreign capital inflows. Vibrant domestic demand growth also led to the emergence of significant deficits on the balance of payments current account. The crisis began when a sharp change in foreign investor sentiment in mid 1997 led to a sudden … severe liquidity squeeze, the emergence of massive bad debts, a collapse in investment and severe recession. (World Bank 2007)

In both instances what started as a financial crisis rapidly turned into an economic crisis and eventually a social crisis. Both were preceded by unprecedented optimism and financial excesses followed by widespread

economic gloom and eventually social and political upheavals. The objective of this chapter is to provide a snapshot of the 1997 financial crisis in Asia, how it was tackled, how it compares with the current crisis, and the lessons they offer for the future.

The chapter will examine the economic crisis and its social effects in five Southeast Asian countries: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. It will argue that the 1997–98 crisis put the population at risk of a social catastrophe due to the lack of a social protection system. The catastrophe was averted only after governments in the worst affected countries hurriedly expanded their social protection with substantial help from international organizations. The current crisis is yet again confirming the need for robust social protection mechanisms that will protect those affected by adverse economic circumstances.

ECONOMIC CRISES

Asia has been struck by economic crises twice within just over a decade: 1997 and 2008. In many ways, the recent crisis is more pernicious than its predecessor, as it follows immediately after energy and food crises. More critically for Asia, however, its Western counterparts are amidst the severest economic recession in more than half a century, which makes the region highly vulnerable to conditions outside its control. In the late 1990s, Western economies were growing at a healthy clip, creating export opportunities for Asian producers that helped speed up the recovery. All Western economies are currently in recession, limiting Asian producers' ability to export their way out of recession. But, on the other hand, the financial systems and government coffers in Asia are in much better conditions compared to other regions or than they were in the region itself a decade ago, offering some protection against the adverse effects of the crisis. However, it is unclear if we are still in the middle or end phase of the crisis; the actual situation may well turn out worse than currently projected.

There are vast differences in the income levels of the five countries covered here. Singapore is one of the richest countries in the world, with per capita income exceeding ten times that of Indonesia and the Philippines, the two other low-income countries in the group. Malaysia and Thailand, on the other hand, are middle-income countries.

The current economic crisis is characterized by growth patterns somewhat different from a decade ago. During the previous crisis, Indonesia and Thailand were worst affected while the Philippines and Singapore were only slightly affected. In 1998, gross domestic product (GDP) shrunk by 13 per cent in

TABLE 3.1
GDP Per Capita (purchasing power parity)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009* Estimate
Indonesia	2,448	2,566	2,221	2,237	2,435	2,550	2,675	2,825	3,005	3,217	3,459	3,728	3,990	4,223
Malaysia	8,231	8,774	8,028	8,442	9,062	9,126	9,581	10,159	10,902	11,610	12,465	13,385	14,225	14,886
Philippines	2,086	2,181	2,144	2,201	2,333	2,382	2,481	2,607	2,764	2,935	3,130	3,383	3,539	3,659
Singapore	26,836	28,583	27,550	29,723	32,852	31,947	33,554	35,996	39,994	43,333	46,893	49,754	51,649	53,281
Thailand	5,012	4,980	4,453	4,672	4,951	5,135	5,457	5,920	6,350	6,840	7,402	7,907	8,380	8,811

Source: IMF, World Economic Outlook <http://www.imf.org/external/pubs/ft/weo/2008/02/weodata/index.aspx> (accessed 1 May 2009).

Indonesia, 10.5 per cent in Thailand, 7.4 per cent in Malaysia, followed by negligible declines in Singapore and the Philippines. In terms of severity, the declines in Indonesia and Thailand have few contemporary parallels. In a reverse image of the preceding crisis, the current crisis has hit Singapore the hardest, with the economy originally projected to shrink by between 6 and 9 per cent in 2009. It is unheard of for a high-income country to experience such a sharp decline in such a short period. Indonesia, on the other hand, will enjoy a relatively healthy growth rate.

Unlike the 1997–98 crisis which had multiple domestic and international causes, the current crisis in Asia is rooted largely in a shrinking global economy and the related decline in exports and investment. The more a country depends on exports, the more adversely it is affected by the current crisis. In early 2009, exports dipped by as much as 41 per cent in these countries. The exception is Thailand, where exports declined by a more modest 28 per cent, but the decline in growth has been severe due to political turmoil in the country. In the case of Indonesia and the Philippines, the decline in exports has not been accompanied by a similar decline in growth rate due to their relatively smaller dependence on exports. The current situation is very different from the earlier crisis when exports actually grew in 1998 in all countries except Indonesia. Without export opportunities, economic recovery from the 1997/98 crisis would have been no doubt slower. See Table 3.3.

The effects of the 1997–98 crisis were aggravated by increases in consumer prices in Southeast Asia. Indonesia was particularly affected, where they increased by 77 per cent in 1998, followed by the Philippines where they increased by 10 per cent. Prices have not increased by the same margin during the current crisis, though the increase is still substantial. The substantial increase in consumer prices in 2008 — by as much as 12 per cent in Indonesia and the Philippines and 6–7 per cent in Malaysia and Singapore — was the result of historically high petroleum and food prices that year. See Table 3.4.

The current economic crisis follows on the heels of the energy and food crises. Prices of fossil fuels — oil, natural gas, coal — and electricity rose steeply in 2006–08, imposing tremendous stress on governments' and households' budgets. As depicted in Figure 3.1, the inflation adjusted price of a barrel of crude oil on the NYMEX (New York Mercantile Exchange) more than doubled to US$60 between 2003 and 2005 and then climbed above US$140 in July 2008. But they began to decline as signs of economic slowdown erupted and within a few months was trading below US$50. Oil prices have a disproportionately large impact on the economy because it is an intermediate product for a range of agricultural, industrial, and

TABLE 3.2
GDP at Constant Prices (% change)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008**	*2009**
Indonesia	8.2	7.8	4.7	–13.1	0.8	4.9	3.8	4.3	4.8	5.0	5.7	5.5	6.3	6.1	3.4
Malaysia	9.8	10.0	7.3	–7.4	6.1	8.9	0.5	5.4	5.8	6.8	5.0	5.9	6.3	4.6	–1.0
Philippines	4.7	5.9	5.2	–0.6	3.4	4.4	1.8	4.4	4.9	6.4	5.0	5.4	7.2	4.6	1.9
Singapore	8.2	7.8	8.3	–1.4	7.2	10.1	–2.4	4.1	3.8	9.3	7.3	8.4	7.8	1.1	–6.0 to –9.0
Thailand	9.2	5.9	–1.4	–10.5	4.4	4.8	2.2	5.3	7.1	6.3	4.6	5.2	4.9	2.6	–2.7

Note: * Projection.
Sources: <https://sdbs.adb.org/sdbs/index.jsp> (accessed 1 May 2009); <http://www.singstat.gov.sg/stats/themes/economy/hist/gdp1.html> (accessed 1 May 2009); <http://siteresources.worldbank.org/INTEAPHALFYEARLYUPDATE/Resources/550192-1238574864269/5976918-1239010682147/update_april09_appendices.pdf> (accessed 1 May 2009); <http://www.singstat.gov.sg/news/news/advgdp1q2009.pdf> (accessed 1 May 2009).

TABLE 3.3
Exports (annual % growth)

	1995	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*Jan-09*
Indonesia	13.4	9.7	7.3	–8.6	–0.4	27.7	–9.3	1.5	9.4	11.5	22.9	17.5	13.2	20.0	–36.1
Malaysia	20.2	6.5	12.1	29.7	12.2	16.1	–10.4	6.9	11.3	21.0	10.9	10.3	9.7	13.3	–34.0
Philippines	29.4	17.7	22.8	16.9	18.8	8.7	–15.6	9.5	2.9	9.5	4.0	14.9	7.1	–2.9	–40.6
Singapore	13.7	5.2	5.3	–1.0	5.7	22.4	–8.3	2.7	—	20.5	14.0	12.8	10.1	12.9	–40.4
Thailand	23.6	0.4	27.9	24.4	–1.4	25.2	4.0	1.4	13.7	16.5	14.6	11.4	16.5	15.7	–28.3

Source: <https://sdbs.adb.org/sdbs/index.jsp< (accessed 1 May 2009).

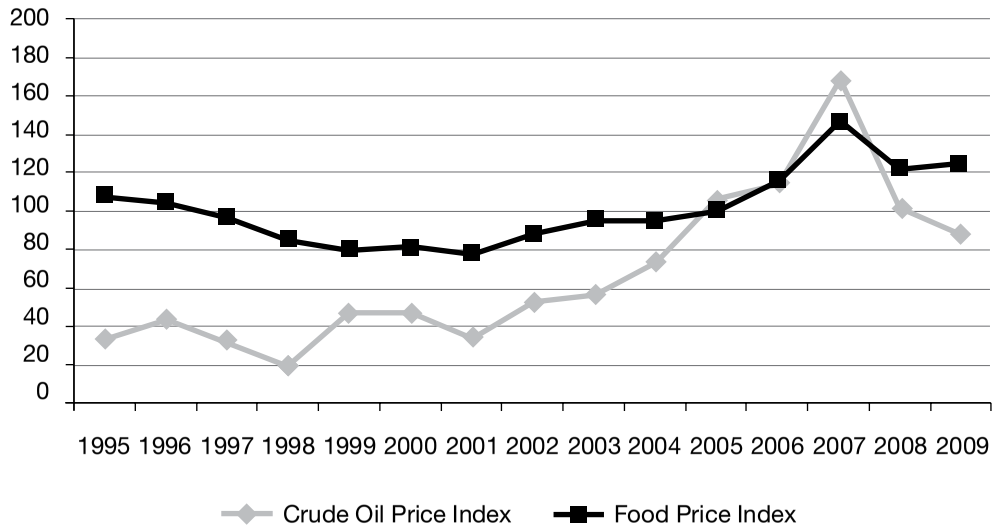
TABLE 3.4
Consumer Price Index (% change)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008**	*2009**
Indonesia	7.9	6.2	58.5	20.3	9.3	12.5	10.0	5.1	6.1	10.5	13.1	6.4	10.9	10.1
Malaysia	3.4	2.8	5.2	2.8	1.5	1.4	1.8	1.2	1.4	3.1	3.6	2.0	6.1	5.0
Philippines	7.5	5.6	9.3	5.9	4.0	6.8	3.0	3.5	6.0	7.6	6.2	2.8	9.7	6.0
Singapore	2	–0.3	0	1.3	1	–0.4	0.5	1.7	0.5	1	2.1	6.5	6.6	3.2
Thailand	5.9	5.6	8.1	0.2	1.7	1.6	0.6	1.8	2.8	4.5	4.7	2.3	6.4	4.1

Notes: *Projected.

Source: <http://www.singstat.gov.sg/stats/themes/economy/hist/cpi.html> (accessed 1 May 2009); Asian Development Bank's Statistical Database System (SDBS). William E. James et al., *The US Financial Crisis, Global Financial Turmoil, and Developing Asia: Is the Era of High Growth at an End?* No. 139, December 2008.

FIGURE 3.1
Petroleum and Food Prices (2005 = 100)



Constructed from data available at <http://indexmundi.com/commodities/?commodity=food-price-index&months=180> (accessed 1 May 2009).

infrastructure industries. The recent decline in oil prices is undoubtedly helpful but its beneficial effects are offset by the prevailing financial crisis.

Food is the largest expenditure item for the poor and, as such, food prices have a disproportionate effect on their living standards. As shown in Table 3.5, in Indonesia food prices rose by 81 per cent in 1998 and 25 per cent in the following year, thus severely affecting the already suffering poor population. The increase was far less steep in other countries, where food prices went up by less than 10 per cent in 1998. These were nevertheless devastating for societies already suffering from declining employment and income. The current crisis was preceded by a massive increase in global food prices. Between 2004 and 2008, prices of wheat, maize, and especially rice increased steeply, but have declined by as much as 40 per cent in recent months. Nevertheless, they remain high relative to longer-term trends and are subject to severe fluctuations.

The recent decline in petroleum and food prices is one of the bright spots on the current economic horizon. In the middle of 2008, when the prices of both had reached historic highs, there were fears that the high price of the two essential commodities would push millions into poverty. On the down side, the decline in food and oil prices in late 2008 was associated with, and indeed triggered by, the slowing economy.

Southeast Asian countries, except for the Philippines, have had low or negligible unemployment rates that rose during the crisis. In 1998 unemployment rose by 17 per cent over the preceding year in Indonesia and the Philippines, 31 per cent in Malaysia, and 189 per cent in Thailand. The rise in Thailand was particularly dramatic, which had nearly full employment in 1997. Little is known about the current unemployment situation in Asia, though with declining growth rates it would be reasonable to expect a significant rise in unemployment. However, Singapore, which is by far the most severely affected by the current crisis, has a substantial (amounting to as much as a quarter of the total) foreign labour force and so has some cushion against a massive rise in unemployment. On the other hand, Singapore has higher unemployment among the resident population than among the total workforce — for instance, unemployment among the former in 2008 was 3.1 per cent compared to 2.2 per cent among the latter — and so the Singaporean may suffer more than suggested by the figure. This is possibly due to the presence of a large number of foreign workers in Singapore who tend to exit the country, and by corollary the labour market, when they lose their jobs.

What is not captured in the unemployment data is underemployment. It is believed that due to the absence of unemployment benefits, in difficult

TABLE 3.5
Food Price Index (% change)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*
Indonesia	9.5	7.2	81.3	24.8	2.7	7.3	10.8	4.7	5.9	10.0	14.8	11.4	
Malaysia	5.8	4.1	8.9	4.6	1.9	0.7	0.7	1.3	2.2	3.6	3.4	3.0	
Philippines	9.6	3.3	8.0	4.6	1.6	4.7	2.3	2.2	6.2	6.4	5.5	3.3	
Thailand	8.8	7.0	9.5	–0.8	–1.2	0.7	0.3	3.7	4.4	5.0	4.6	4.0	

Source: Asian Development Bank's Statistical Database System (SDBS) <https://sdbs.adb.org/sdbs/index.jsp> (accessed 20 April 2009).

TABLE 3.6
Unemployment Rate (%)

	1996	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*
Indonesia	4.9	4.7	5.5	6.4	6.1	8.1	9.1	9.6	9.9	11.2	10.3	9.8	—
Malaysia	2.5	2.4	3.2	3.4	3.0	3.5	3.5	3.6	3.5	3.5	3.3	3.2	—
Philippines	8.6	8.8	10.3	9.8	11.2	11.1	11.4	11.4	11.8	7.8	7.9	6.3	6.8
Singapore	2.7 ('95)	2.4	3.2	4.6	4.4	2.7	4.2	4.5	4.4	4.2	3.4	2.3	2.2
Thailand	1.5	1.5	4.4	4.2	3.6	3.3	2.4	2.2	2.1	1.8	1.5	1.4	1.4

Sources: <https://sdbs.adb.org/sdbs/index.jsp> (accessed 20 April 2009); Statistics Singapore, Census of Population <www.singstat.gov.sg/pubn/popn/ghsr1/chap3.pdf> (accessed 1 May 2009); <www.singstat.gov.sg/pubn/popn/c2000adr/chap6.pdf> (accessed 20 April 2009); Statistics Singapore, Singapore in Brief <www.singstat.gov.sg/pubn/reference/sib2009.pdf> (accessed 20 April 2009).

economic times many laid off workers in the affected countries simply reduce the hours they work or shift to the informal sector on a part-time basis. This is believed to be particularly true in countries with large agricultural sectors, such as Indonesia and Thailand. In Indonesia, underemployment rose from 37 per cent of the labour force in 1996 to approximately one half in 1998, whereas in Thailand it rose from 1.7 per cent in 1998 to 3.6 per cent in 1999.

The economic slowdown during the 1990s crisis was accompanied by an increase in poverty, with the $1/day poverty headcount index increasing from 15.1 to 15.9 in developing East Asia between 1996 and 1999 (Atinc 2003). However, the most significant impact is discernible in the $2/day poverty headcount index: by this measure, poverty increased from 50.9 to 51.2 in developing East Asia and from 43.6 to 52.8 in Southeast Asia over the 1996–99 period. This confirms that there were a lot of people in the adversely affected countries living just above the poverty line who were pushed under it by the crisis. It is estimated that between 1997 and 1998 the poverty rate increased from 11.3 to 18.2 per cent in Indonesia, from 8 to 10 per cent in Malaysia, and from 10 to 13 per cent in Thailand. Even after the recovery from the 1990s crisis, there were a lot of vulnerable people in the region, as Table 3.7 shows.

It is still early to estimate the effects of the current crisis on the poor. In the forecast issued in February 2009, the World Bank estimated that as many as fifty-three million additional people around the world could be trapped in poverty due to the economic crisis (World Bank 2009). It further predicted that 200,000 to 400,000 more babies could die each year between now and 2015 if the crisis persists.

In Indonesia more than 55 per cent of the working population lives on an income of less than US$2 a day and so a lot of people are likely to

TABLE 3.7
Poverty Headcount Ratio (purchasing power parity), 2003
(% of population)

	$1 a day	*$2 a day*
Indonesia	6.5	50.5
Malaysia	0.2	9.0
Philippines	14.1	44.4
Thailand	0.7	27.8

Source: <https://sdbs.adb.org/sdbs/index.jsp> (accessed 20 April 2009).

be pushed into extreme poverty by even a small loss in income. Poverty incidence, which fell from 16.6 per cent in March 2007 to 15.4 per cent in March 2008, is expected to slow its decline this year (ADB 2009). While the overall poverty rate in Malaysia was only 3.6 per cent in 2007, it was as high as 7.1 per cent in rural areas (compared to 2 per cent in urban areas) and 16 per cent in the state of Sabah (ADB 2009). In the Philippines, even before the current crisis, the incidence of poverty was at 32.9 per cent of the population in 2006 and rising. The current economic crisis and the sharp reduction in remittances sent by Filipino workers are likely to further increase poverty (ADB 2009). Singapore does not publish poverty data and so it is impossible to estimate the poverty situation in the island state during the previous or the current crisis.

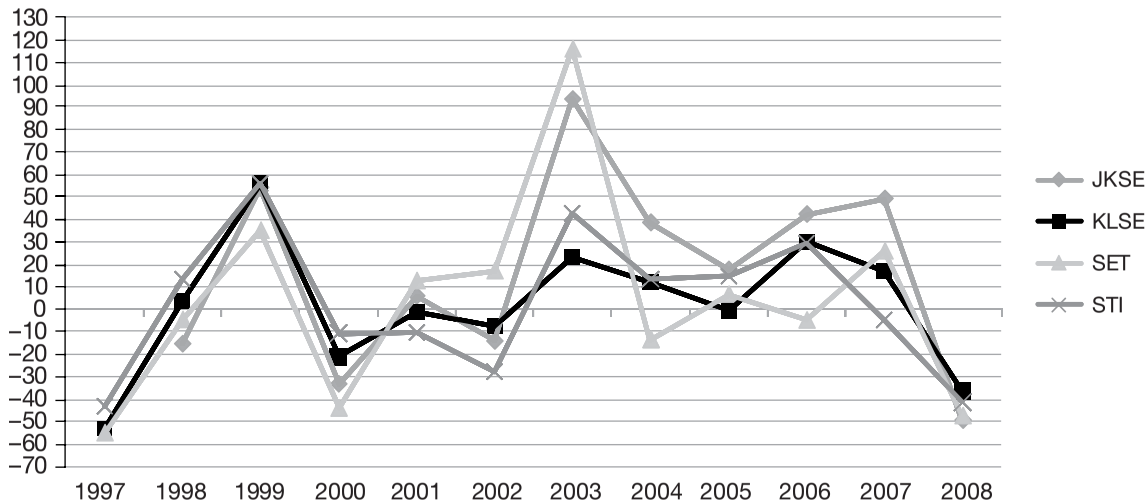
While the fate of the poor is unknown, we do know that the well-off have been hit hard by the crisis. In 2008, stock market indices in Malaysia (KLSE), Singapore (STI), and Thailand (SET) declined by 37, 41, and 48 per cent respectively. The magnitude of the decline is similar to the one experienced in 1997 when these indices fell by 53, 43, and 55 per cent respectively. See Figure 3.2.

The decline in the stock market has been accompanied by a sharp deterioration in real estate prices. Foreign investors have been fleeing the region and the inflow of foreign equity, loans, and bond finance have more than halved since their peak in 2007. The combined effect of the decline in asset prices is manifested in seriously pessimistic consumer sentiment which in turn has undermined business confidence (Kato 2009). Weak business confidence is self-perpetuating: if businesses do not feel confident, they withhold investments, which adversely affects production and income, which further undermines consumer sentiments. Current economic conditions are unlikely to improve until business feels more optimistic about the near future and begins to invest.

The decline in economic activity in 1998 was accompanied by shrinking government revenues, as total government revenues as a percentage of GDP declined in Indonesia, Malaysia, the Philippines, and, especially, Thailand (and probably also Singapore, though comparable data is not available). However, government expenditures declined only in Thailand, while it increased in the others, leading to budget deficits of varying magnitude.

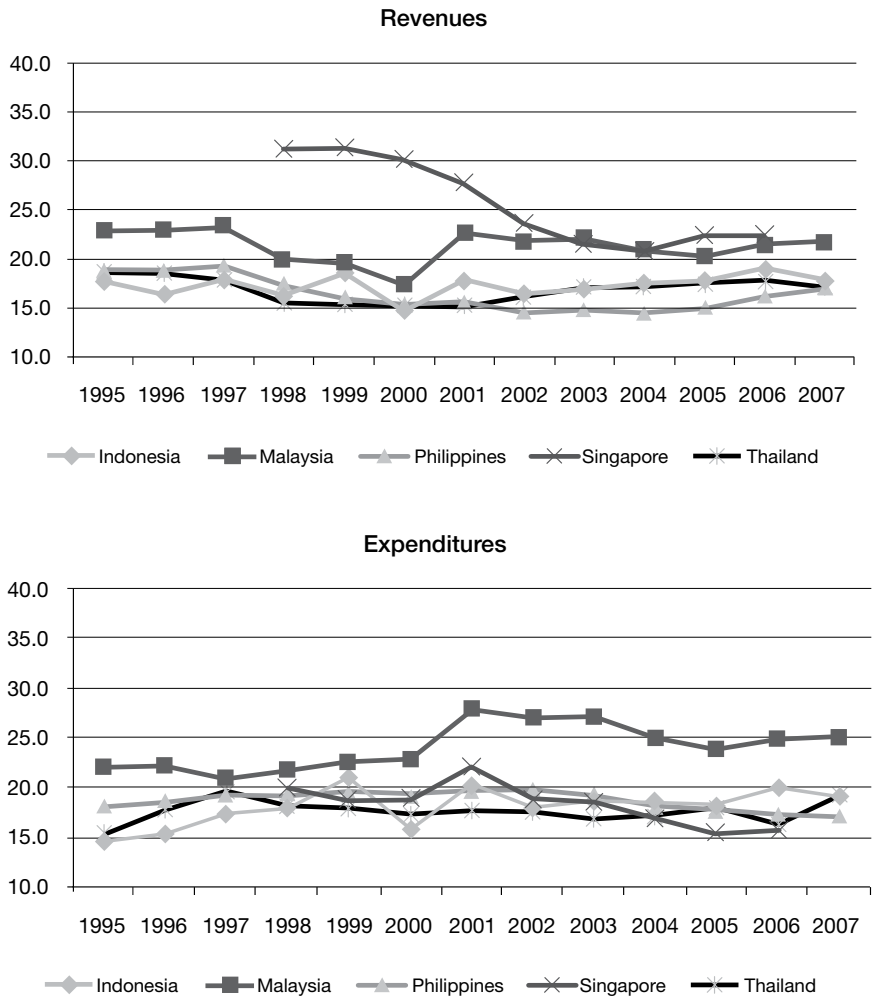
The budget deficit resulting from increased or stable expenditures at a time when revenues were declining was particularly large in Malaysia, the Philippines, and Thailand. Singapore, on the other hand, continued to enjoy a budget surplus of 3.4 per cent of GDP in 1998 and 7.1 per cent in 1999, suggesting it had considerable fiscal leeway for expanding social protection.

FIGURE 3.2
Stock Market Index (% change)



Sources: Yahoo! Finance <http://finance.yahoo.com/intlindices?e=asia> (accessed 1 May 2009); Stock Exchange of Thailand <http://www.set.or.th/th/market/files/Table_Index.xls?date=1975> (accessed 1 May 2009).

FIGURE 3.3
Public Revenues and Expenditures (Total, % of GDP)



Source: <https://sdbs.adb.org/sdbs/index.jsp> (accessed 20 April 2009).

Increasing unemployment and declining income due to economic slowdown are typically associated with higher spending on social protection due to increased unemployment and poverty. However, this did not occur in the crisis-struck countries in Asia: social policy expenditures as a percentage of GDP increased only slightly in Malaysia and Thailand and even declined

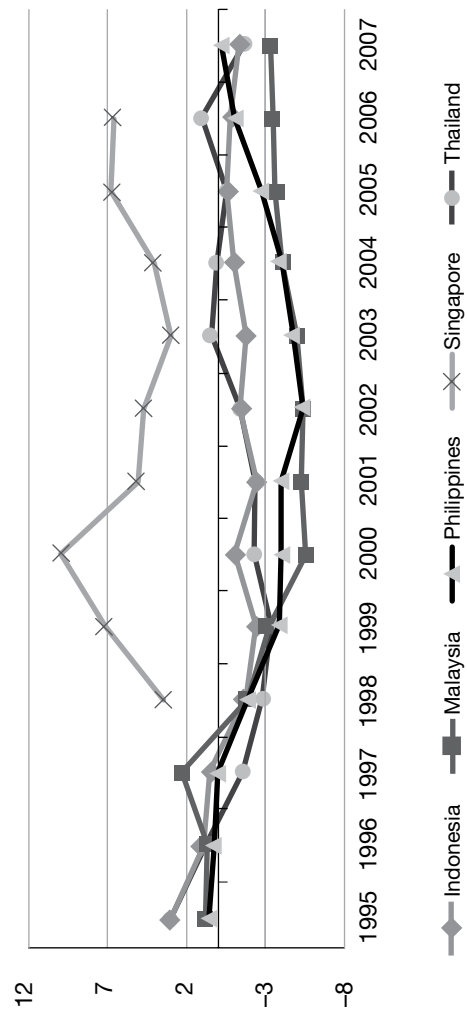
somewhat in Indonesia in 1998. In Indonesia there was a noticeable increase in 1999, more than a year after the onset of the crisis, before falling again in the subsequent years. Only in Malaysia was there a substantial and continuous increase between 1997 and 2003, when it began to decline. In other countries, social policy expenditures' share of GDP has consistently declined since 2000, reflecting improved economic conditions but also ebbing of government interest in social protection issues.

There are substantial differences across Southeast Asian countries not only in terms of the financial resources they devote to social policies but, more significantly, how they are apportioned. The only common feature among them is the largest proportion typically devoted to education, which is unsurprising given their youthful demographics. In Indonesia, social welfare has typically been the second largest expenditure item, but in the crisis years it was community amenities (much of it related to public works projects with an income generation purpose) that attracted the largest proportion. The small share devoted to health in Indonesia is noticeable. In Malaysia, in contrast, health attracts the second largest share, while housing receives a very small proportion. The Philippines is a small spender on social policy overall and much of it is devoted to education and social welfare. Singapore is remarkable not only for the small sum it spends on social policy overall (especially when its income level is taken into account) but also for the large share it devotes to housing and the small share to social welfare. Thailand, similar to Malaysia, is remarkable for the large share it devotes to healthcare and the small share to housing.

When the crisis erupted, all relief efforts were concentrated on reviving the economy while the social repercussions of the decline were neglected. Micro level surveys in Indonesia and Thailand carried out in early 1998 pointed to the social havoc the crisis was causing: children were being pulled out of schools, nutrition levels were declining, health care access was shrinking, and so on. The findings, albeit patchy and cursory, painted a grim picture of the emerging social reality, galvanizing governmental and non-governmental organizations (NGOs), both domestic and international, into action. By mid-1998, social protection programmes had been established or expanded — with significant funding from international organizations and Japan — in Indonesia, Malaysia, and Thailand. The social indicators stabilized and eventually improved as the programmes began to have their intended effects.

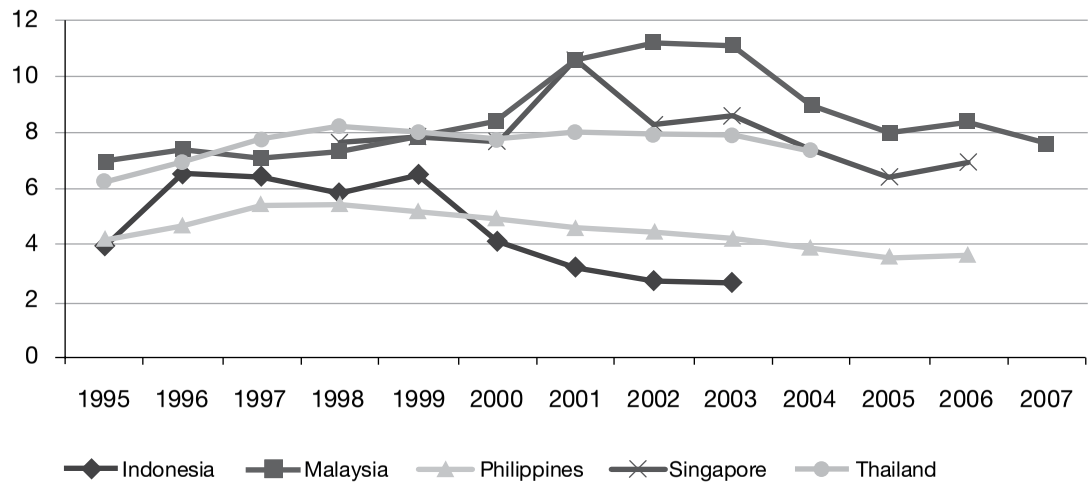
Fortunately, the nutritional content of the population's diet was not significantly affected by the crisis. As shown in Table 3.8, dietary protein consumption and dietary energy consumption declined slightly between 1995–97 and 1999–2001. Exceptions are in the Philippines, where dietary

FIGURE 3.4
Overall Budgetary Surplus/Deficit, Central Government (% of GDP)



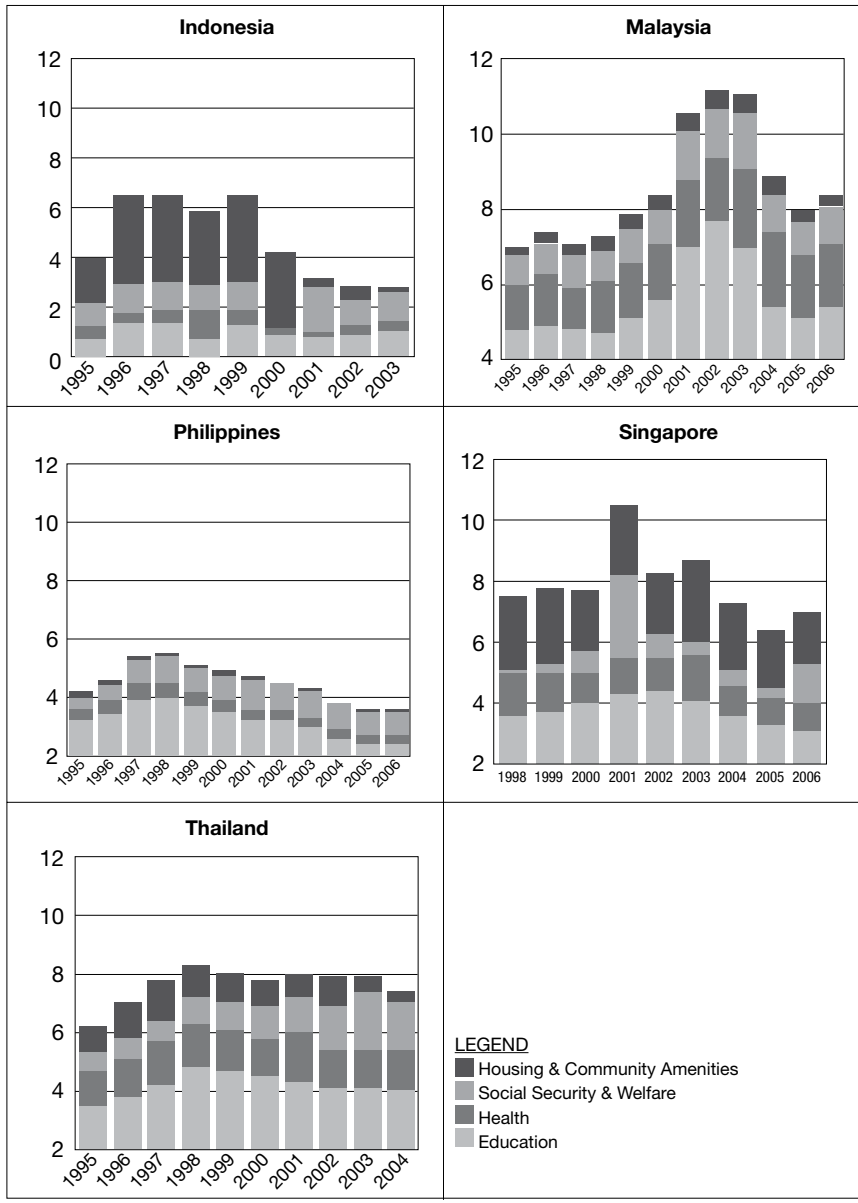
Source: <http://sdbs.adb.org/>.

FIGURE 3.5
Social Policy Expenditures (% of GDP)



Note: Includes public expenditure on education, health, housing and community services, and social security and welfare.
Sources: <http://sdbs.adb.org/>; IMF (2009*a*).

FIGURE 3.6
Public Expenditures on Social Policy (% of GDP)



Sources: <http://sdbs.adb.org/>; IMF (2009*a*).

TABLE 3.8
Dietary Patterns: Indonesia, Malaysia, Philippines, and Thailand: 1995–97 and 1999–2001

	Dietary Protein Consumption (g/Person/Day)		*Dietary Energy Consumption (Kcal/Person/Day)*	
Country	*1995–97*	*1999–2001*	*1995–97*	*1999–2001*
Indonesia	54	52	2,500	2,471
Malaysia	77	76	2,950	2,854
Philippines	55	56	2,380	2,422
Thailand	58	56	2,370	2,394

Sources: 1995–97, compiled from FAO database <www.fao.org/economic/ess/food-secutiry-statistics/en> (accessed 2 April 2010); 1999–2001, compiled from *FAO Statistical Yearbook 2009* <http://www.fao.org/economic/ess/publications-studies/statistical-yearbook/fao-statistical-yearbook-2009/d-consumption/en/> (accessed 2 April 2010).

consumption of protein and energy increased marginally, and in Thailand, where dietary energy consumption rose slightly. The trends suggest realignment of expenditure patterns under times of financial stress.

Table 3.9 shows that data for immunization rates indicate mixed trends, but no widespread deterioration. During the crisis years, immunization against measles declined slightly in Indonesia and (for reasons unclear) Singapore, remained stable in Malaysia, and increased in the Philippines and Thailand. Surprisingly, immunization rates for DTP3 improved in Indonesia and Thailand and declined in Malaysia, the Philippines and Thailand. Similarly, Hepatitis B immunization increased in Indonesia and Thailand, fluctuated in the Philippines, remained stable in Malaysia, and declined slightly in Singapore. The improvement in Indonesia and Thailand and the stable or declining rates in Malaysia and Singapore may be explained by the strong involvement of NGOs and intergovernmental organizations in the former group but not the latter.

Other data also show improvements or no change in health status during the 1997–98 crisis (Bhutta 2009). Unfortunately, reliable comparable enrolment data are still not available for the years 1997 and 1998 to be able to comment on the effects of the economic crisis on education (see World Bank, Asian Development Bank, and UNESCO statistical databases). Cursory evidence that is available indicates that the overall impact was mixed, with enrolment rising in some cases and declining in others.

TABLE 3.9
Immunization of One-year-olds (%)

	One-year-olds immunized against measles (%)					*One-year-olds immunized with three doses of DTP3 (%)*					*One-year-olds immunized with three doses of Hepatitis B (%)*				
	1996	*1997*	*1998*	*1999*	*2000*	*1996*	*1997*	*1998*	*1999*	*2000*	*1996*	*1997*	*1998*	*1999*	*2000*
Indonesia	79	77	75	74	72	72	73	74	74	75	62	65	76	77	65
Malaysia	86	86	86	87	88	94	95	94	93	95	87	91	91	91	94
Philippines	76	79	80	80	81	75	81	80	80	80	35	31	35	32	19
Singapore	97	98	96	97	96	97	98	97	97	98	96	97	96	96	97
Thailand	92	93	94	96	94	94	95	97	97	97	93	94	94	95	95

Source: WHO Statistical Information System (WHOSIS) database <http://www.who.int/whosis/en/index/html/> (accessed 1 April 2010).

SOCIAL PROTECTION

When the crisis broke out in late 1997, no country covered in this study had social protection arrangements adequate for the massive task at hand and, as a result, had to hastily expand existing programmes and establish new ones in an ad hoc manner. Very little is known about the social impacts of the current crisis and even less about the governments' responses to them. Yet there are discernible patterns of similarities and differences between the two crises that suggest the need for a more systematic response.

Indonesia

Indonesia was hit very hard by the 1997 crisis, even though the economic and social deterioration did not turn out to be as disastrous as initially predicted by some analysts (Ananta 2003). The poor urban dwellers were the most affected by the crisis, due to the sharp increase in the price of basic foodstuffs. The only social protection that existed at the time included subsidized fuel and rice available to the entire population regardless of income. Fuel subsidies alone accounted for half of the total government spending on social protection, food subsidies for 40 per cent, and subsidies for electricity, medicines and fertilizers for the remainder (Blomquist et al. 2001).

Without experience or financial resources to handle the crisis, the government left the task of devising a response to the International Monetary Fund, which in the beginning concentrated almost exclusively on stabilizing the financial system and reigning in public finances. In mid-1998 the government announced JaringanPengamanSosialor "Social Safety Net" (SSN) programmes with support from the World Bank. The 1998–99 budget allocated 30 per cent of total public expenditures to SSN programmes (Bakti n.d., p. 53). Of the total spent on social safety nets, 26 per cent was for education, 17 per cent for regional development, 12 per cent for education, and 8 per cent for transportation infrastructure. With the cost of general subsidies rising, in 1998 the government replaced the subsidy for all rice with a subsidy only for lower quality rice (the Operasi Pasar Khusus or OPK programme), which by mid-2000 reached about thirteen million families at the cost of Rp5 trillion. The government also launched a labour-intensive public works programme (Padat Karya) which created fifty-eight million days of labour for 400,000 people at the cost of nearly Rp10 trillion (World Bank 2000, p. 124). Furthermore, it launched the Pemberdayaan Daerah dalam Mengatasi Dampak Krisis Ekonomi programme (Empowering Regions to Overcome the Impact of the Economic Crisis) which provided grant and revolving credit funds

to poor and unemployed groups to improve infrastructure while generating employment. To maintain access to critical public services, the government spent almost a trillion rupiah on schools, scholarships, and a school lunch programme in 1998–99 (Blomquist et al. 2002). There were media campaigns and community efforts to encourage children to stay in school. Grants were also given to village health centres for critical health services and nutritional support for mothers and infants.

Although Indonesia currently has one of the fastest growing economies in Asia, the government has acted swiftly to address the slowdown. With parliamentary elections due in April 2009, the government did not want to take chances and announced a fiscal rescue package worth Rp68 trillion (US$6.3 billion), or 1.3 per cent of GDP for the year 2009. Much of the money is for economic development: of the total, Rp12.2 trillion is for infrastructure and community empowerment programmes; Rp4.8 trillion for energy-saving projects, and Rp2 trillion for roads in municipalities and villages, and irrigation schemes in villages.

Indonesia is better prepared now than it was at the outbreak of the previous crisis. Many of the SSN programmes established during the previous crisis have been retained and even strengthened. Unlike 1997 when the government had difficulty identifying the poor for the purpose of providing relief, the government now has a register of poor households constructed on the basis of the 2000 census, which identified 19.1 million poor households in the country. Such households are eligible for health insurance and subsidized rice (RASKIN). Scholarships for children from poor households are available through their schools. The PNPM Mandiri programme, which is directed at communities rather than households, provides block grants for development purposes to sub-districts. By 2009, the PNPM Mandiri programme reached every sub-district in the country and is planned to serve as the public works platform if there is a need for it.

Malaysia

Although in a better condition than most of its neighbours, the Malaysian economy began to deteriorate rapidly in late 1997 and by 1998 unemployment had risen to 5.2 per cent of the labour force and head count poverty to 8 per cent. Widespread acute poverty was avoided, however, as employment levels held up relatively well and there were government programmes to provide relief to the poor.

With economic conditions deteriorating rapidly and continuously for nearly a year, in July 1998 the government announced a major policy response

comprising currency controls and fiscal expansion. It fixed the exchange rate, restricted the convertibility of the national currency, and decided to merge and recapitalize troubled banks rather than let them fail. Furthermore, of the nearly two million foreign workers (who formed nearly a quarter of the total labour force) legally or illegally in the country, approximately one million returned voluntarily or were sent back to create employment opportunities for Malaysians.

Most significantly for social policy, the government decided to reduce interest rates and increase rather than decrease public spending, as had been the case in countries relying on International Monetary Fund (IMF) support at the early stages of the crisis. It allotted more than RM2 billion for food and fuel price subsidies, job retraining, pensions, micro-credit for small entrepreneurs, and education funds to help students from poorer families. In addition, RM5 billion was allocated for infrastructure projects to boost economic activity. As a result of its increased expenditure commitments, the government's budget deficit reached 5.5 per cent of GDP in 2000, which was a steep rise from a healthy surplus in 1997.

The fiscal stimulus combined with the return of foreign workers eased unemployment pressures and halted deteriorating economic conditions. The Malaysian Government's long experience with anti-poverty efforts among poor Malays, especially in rural areas, helped in countering the crisis. Particularly significant was the role of public hospitals and public schools which continued to provide services nearly free of charge. Fortuitously, the government had not succeeded in its early 1990s plans to expand the role of private hospitals which would have made it difficult to meet the needs of the poor during the crisis. Thus the programmes originally designed to uplift the economic status of ethnic Malays helped in preventing significant decline in the population's education and health status despite increased poverty.

The government has reacted decisively to the current economic turmoil, announcing two rescue packages. The first package was worth RM7 billion (US$2 billion), amounting to 0.9 per cent of GDP, a significant proportion of which was for low- and medium-cost housing (US$0.3 billion) and micro-credit facilities (US$57 million). In response to the deteriorating economic outlook, the second package was eight times larger, comprising RM59 billion (US$16.4 billion) or 9 per cent of GDP. The bulk of the funds are for assisting firms: tax cuts and incentives worth RM3 billion; a working capital guarantee scheme worth RM5 billion; a restructuring loan guarantee scheme worth RM5 billion; and a new financial guarantee institution costing RM15 billion. In addition, equity investments worth RM10 billion are to be channelled to telecommunications, technology, and tourism by the government-owned

Khazanah. The package also includes RM15 billion for schools. There is, however, no separate allocation for the poor, who are likely to be most affected by the crisis. But public hospitals and public schools are expected to continue to provide protection without means tests.

The Philippines

After losing much of the 1970s and 1980s to Marcos' misrule, and only gradually recovering from it, the Philippines was in no position to face deep or prolonged economic crisis in 1997–98. Fortunately, it was spared the worst ravages of the crisis as the economy showed surprising resilience, partly because it had not benefited from the sort of hype that had raised its neighbouring economies to dizzying heights and partly because it had already undertaken many critical financial sector reforms. Yet all was not well. The 1997 crisis was preceded by El Niño droughts that had devastated rural incomes. In 1998 the economy shrunk by 2.6 per cent, even though this was one of the better performances in the region. Similarly, unemployment, which stood at 8.6 before the crisis, rose moderately to 10.1 per cent in 1998. The poverty rate increased by 3 per cent in 1998, rising to 35 per cent of households (Bautista u.d., p. 124). The decline in government revenues reduced government spending overall, yet public spending on education increased by 3.8 percentage points, though health spending declined by 7.8 percentage points.

Given the relatively small effects of the crisis and given that the government and population in the Philippines were used to grim economic circumstances almost continuously since the 1970s, there was no launch of any significant social protection programme in response to the crisis. Existing programmes continued, despite an increase in the number of people in need of support: Enhanced Retail Access for the Poor (ERAP), Sari-sari Rolling Store, the Rice Subsidy Program, the Emergency Relief Assistance Program, Medical Assistance for Indigent Families, and the Rural Works Program (Bautista n.d., p. 125). The programmes, however, lacked financial resources and were marred by a lack of administrative capacity. On the other hand, the Philippines had a high NGO presence and many of them expanded their efforts to help those in need.

Early into the 2008 crisis, President Arroyo set aside P4.5 billion from VAT collections for "pro-poor" employment and livelihood programmes (National Economic and Development Authority 2008). The 2009 budget provides for economic stimulus of P300 billion, exceeding 3.3 per cent of GDP. The stimulus package emphasizes "easy to implement projects" like

repair and rehabilitation of roads, hospitals, bridges, and irrigation facilities (Yap 2009).

Singapore

During the 1997–98 crisis, Singapore was the least affected country in the region, even though it was one of the worst times for the island state since its independence. In 1998, GDP shrunk by 1.4 per cent, compared to an increase of 8.3 per cent in the preceding year, and the unemployment rate doubled to 4.4 per cent. While these figures do not appear all that painful, they indicate a serious reversal in fortune for a nation used to some of the highest growth rates in the world almost continuously for three decades.

The overall economic situation in Singapore was not all that dire in 1998, although those living on the margins suffered. However, the government was adamant that there was no need for a social protection system. The Minister of Finance declared: "Our strategy has been to encourage economic self-reliance by promoting social mobility. Instead of providing large unemployment benefits and price support schemes, we prefer job creation and market competition. The provision of subsidies has been selective and confined mainly to education, healthcare, and public housing" (Hu 1997). As a senior official from the Ministry of Manpower later clarified, "the best way to assist individuals who are retrenched or unemployed is to help them seek reemployment instead of handing out financial support such as unemployment benefits" (quoted in Cheung 2000). To lower labour costs and thus boost employment opportunities, the government reduced the rate of mandatory contributions to the Central Provident Fund (CPF) by employers by 10 percentage points. It also expanded programmes for job training, course fee subsidization, counselling, and job data bank services. Examples of such programmes included the Skills Re-development Programme and Education and Training Fund administered by the National Trades Union Congress, Interest-Free Loan Scheme for Skills Training and Upgrading administered by the Ministry of Community Development, and the Employment Placement Assistance Programme administered by the Ministry of Manpower (Cheung 2000).

In early 1998, the government introduced an off-budget package worth approximately US$2 billion, aimed almost entirely at reducing business costs. With the conditions deteriorating, in November 1998 it announced a larger aptly-named Cost Reduction Package worth S$10.5 billion aimed at reducing business costs by 15 per cent. A corporate tax rebate of 10 per cent was offered, wages were cut by 15–18 per cent, employers' contribution

rate to CPF was halved to 10 per cent of wages, and the foreign workers levy for skilled workers was reduced. In February 1999, further relief measures were offered: in addition to several measures to reduce business costs, the government also doubled the personal income tax rebate to 10 per cent and offered rebates on conservancy and utilities charges. There was nothing in the three packages targeted directly at helping the poor.

The only assistance available to low-income households was public assistance, designed for the destitute, the disabled, and the elderly with no other source of income or family to turn to. There are no clear eligibility criteria for receiving benefits under the programme and programme administrators are allowed to exercise a considerable amount of discretion. In the face of the crisis, the government did establish small ad hoc programmes to meet the expanded need for income support. Thus Community Development Councils gave interim financial help, though only seventy-two persons were assisted with S$23,380 in total until July 1998. In addition, the Housing Development Board deferred or reduced payments of mortgages and the Education Ministry waived school fees. The reason for lack of broader programmes was partly due to the moderate nature of the crisis in the island state, but also the government's deep conviction that "handouts" were undesirable as they promoted dependency among recipients.

The current crisis is different, however, as Singapore is the most severely affected country in the region. It has announced a substantial stimulus package, amounting to S$35 billion (US$13.6 billion) or 8 per cent of GDP. Of the total, S$5.1 billion is for labour market programmes, including training and Workfare income supplement. Another S$5.8 billion is for various schemes to assist banks' lending activities, while S$2.6 billion is for supporting firms' business cash flow and enhancing their competitiveness. Unlike previous episodes of economic difficulties, however, this time there is funding for social policy items. Thus S$2.6 billion has been allocated for public assistance for households and tax concessions and grants for charities. Recipients of Workfare, which gives cash grants to low-income working households, will get 50 per cent more in transfer payments. In addition, S$4.4 billion has been set aside for rejuvenation of public housing estates, upgrading of education and health infrastructure, and enhancement of sustainable development programmes.

The centrepiece of the government's effort to protect the poor during the current crisis is the S$4.5 billion Jobs Credit Scheme. To prevent layoffs, the scheme offers cash grants to the maximum of S$300 to employers to cover part of their wage bill. The subsidy gives employers an incentive to retain workers by reducing their part of contribution to their employees' pensions.

The scheme is projected to save up to 30,000 jobs in 2009 and 50,000 each in 2010 and 2011 (Abeysinghe and Gu 2009).

Thailand

The 1997–98 crisis affected Thailand severely, next only to Indonesia in severity. The sharpest impact of the crisis was in the form of increased unemployment, which rose from almost nil to 4.5 per cent and a much higher underemployment in 1998. The government's response to the crisis was initially concentrated on fiscal discipline, reflected in reduction of nearly 16 per cent in public expenditures in 1998. Social policies were particularly targeted: in 1998, public expenditures on social services were reduced by 35 per cent, on health by 11 per cent, and on education by 4 per cent (Kittiprapas 2002). Besides fiscal discipline, the government emphasized creation of jobs by reducing business costs. It reduced the statutory social security contribution rate from 1.5 per cent of wages to 1 per cent each for the employer, employee, and the government.

Programmes with a significant income-support component were not launched until April 1999, when the government announced a fiscal package worth about 1 per cent of GDP financed from funds provided by international agencies. Two new funds, the Social Investment Programme and the Social Sector Programme, were established to provide loans and grants to programmes targeted at the poor. The subsidized student loan fund was increased from $220 million in 1998 to $400 million in 1999, while the existing programme waiving tuition fees in schools was expanded. To maintain access to health care, the government expanded the Low Income Health Card programme (which covered 20 per cent of the population in 1998) that entitled holders to receive a package of health services at public facilities at nominal charges. The government also extended the health insurance cover for covered workers (largely those employed by private firms in the formal sector) from six months to one year after loss of employment.

To deal with the current crisis, the government has announced a package worth 127 billion Thai baht (US$3.6 billion) amounting to 1.1 per cent of GDP. Of this, nearly a third (40 billion baht) is in the form of tax cuts, which by their very nature can only reach relatively well-off people. Of the rest, 4.3 billion baht is for rural construction projects and 15.2 billion baht for community-driven development initiatives (Sufficiency Funds). There is also 19 billion baht for free education. To boost aggregate demand, the government has offered cash transfers amounting to 9 billion baht to pensioners, 19 billion baht to civil servants and low-income social security

fund beneficiaries, and another 11.4 billion baht in bus and rail travel and utility vouchers for low-income people.

A significant proportion of the allocated spending during the current crisis is for regular government functions rather than social protection: 6.9 billion baht for training the unemployed, 3 billion baht for recruitment of health volunteers, and 1.1 billion baht for improvement of health stations. Other such spending include 0.5 billion baht for the food industry and the promotion of small and medium enterprises; 1 billion baht for tourism promotion; 0.3 billion baht for national image rehabilitation; and 1.8 billion baht for housing for junior police officers. In addition, 4.1 billion baht is to be channelled to building a budgetary reserve for emergencies and 19.1 billion baht as transfers to government accounts.

CONCLUSION

The experience of the 1997–98 Asian economic crisis serves as a reminder of how rapidly poverty can rise under recessionary conditions, causing long-term political and social dislocations. The slide in school enrolment and health care utilization in the worst-affected countries in Asia during the early phase of the crisis was halted only after governments, with the support from international organizations, intervened with ameliorative measures. If the current economic crisis deepens and governments dither in responding to it, there is a chance of repeating what happened a decade ago.

There are indications that Southeast Asian governments are taking the current crisis more seriously than was the case in 1997–98. Every government in the region has announced policy measures to address the crisis. Even the International Monetary Fund (IMF), which played a critical role in preventing the affected countries from expanding social protection a decade ago due to its obsession with fiscal discipline, seems to have learnt its lessons and is counselling expansion of social protection. As it noted recently, "Given the economic downturn, efforts to strengthen safety net programmes to protect the poor become more urgent. Transfer programmes that effectively target the poorest often result in a larger stimulus to aggregate demand, given their higher propensity to consume" (IMF 2009*b*).

The question remains whether Southeast Asian governments have learnt sufficiently from the previous crisis to prepare for the social consequences of the current crisis. After all, the best time to establish a social protection system is before rather than during the crisis due to the reduced fiscal capacity when in the middle of a crisis and the possibility of lasting damages while programmes are being established. Here the answer is less sanguine.

Only Indonesia continued the task of building its social safety nets after recovery from the previous crisis by regularizing and reinforcing its SSN system. Yet the system may not hold up against a severe deterioration due to the government's weak political and administrative capacity and uncertain public finances. In Thailand, the establishment of the universal health insurance in 2001–03 will serve those who require health care regardless of whether there is a crisis or not. Other than that, Thailand did not establish any programme that will offer significant protection in the event of social deterioration. Similarly, Malaysia and Singapore did not establish any social protection programme to help those who experience a sudden decline in income, though they continue to have a publicly provided and funded education and health care system that will serve the population during crises. However, the Singapore Government began to reconsider its deep scepticism towards social welfare in the wake of the 2005 elections and launched the Workfare programme. But the programme is designed to enable low-income workers to contribute towards their pension rather than to maintain current income.

A closer look at the policy announcements to counter the current crisis suggests that Southeast Asian governments continue to tie social protection to economic imperatives. Most of the measures announced in response to the crisis are directed at boosting the economy rather than protecting those affected by the crisis. While boosting the economy is a desirable objective, it is a separate, albeit closely related, issue. Economic stimulus is not a substitute for social protection; the two need to be pursued simultaneously and not in isolation or independently.

Governments need to overcome their ideological aversion to social welfare and the belief that Asian societies are somehow unique which averts the need for social protection. Policymakers in the region need to realize that the market and families are ill-suited to provide an adequate amount of social protection to all those who need it, especially during an economic crisis when the market is the source of the problem and families have reduced resources available to help their kin. They also need to accept that countries that offer social protection to their populations reap tremendous economic, in addition to political and social, benefits in both the short and long terms (Grosh, Ninno, and Ouerghi 2008).

It is simply good governance for governments to prepare for eventualities. Governments have, after all, long prepared for fire services and natural disasters, and, in recent years, for financial market collapses. Economic crises in a globalized world have many features in common with natural disasters, in that they are unpredictable and are too large in magnitude for households

to cope on their own. It is not possible for individuals and households to protect themselves against deep and prolonged economic contractions. This can only be done at the national level through the government employing its sovereign authority.

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4

EDUCATION AND EMPLOYMENT OF THE POOR IN LAOS

Myo Thant[1]

The Lao People's Democratic Republic (Lao PDR) has for the second time in slightly more than a decade been subjected to the vagaries of the global economy. The adoption of market reforms in 1986 generated steady economic growth which was momentarily but sharply derailed by the 1997 Asian financial crisis and ensuing policy responses which were counterproductive. This chapter examines how vulnerable the Lao PDR is to the recent global economic crisis and particularly its attempts to develop the education sector which is critical for the reduction of poverty and the country's aim of graduating from its LDC (least developed country) status by 2020. The chapter argues that contrary to some expectation that its physical isolation, size, and limited interaction with global financial markets would protect it from the global slowdown, recently established linkages with the global economy threaten the progress that has been achieved. The country has weathered the global crisis better than many other countries in the region but the impact is being felt.

The chapter consists of three main sections and a concluding section. The first section relates the key demographic and geographical features of the country and the evolution of the economy since 1986. Despite steady economic growth, poverty is still substantial, particularly in the remote areas where ethnic minorities constitute the majority of the populace. The second section discusses the education sector of the country. Progress in terms of spreading literacy, improving access to primary schools, and creating a system

of higher education has been substantial, but low efficiency and quality are major and pervasive challenges. Three sub issues which are key variables in terms of the impact of the recent crisis on the education sector are discussed: demand for education, expenditure on education including external assistance, and decentralization of education functions.

The third section examines the impact of the economic crisis on the education sector and asks two important questions. First, is the Lao PDR vulnerable to the recent crisis and, if so, what are the determinants of this vulnerability. Second, how can policymakers best respond to the crisis. The chapter argues that while there is still a great deal of uncertainty, the solutions lie in ensuring macroeconomic stability, explicitly addressing Lao-specific transmission paths of the recent economic crisis, and careful review and selective use of interventions used after the 1997 Asian financial crisis in other regional countries.

DEMOGRAPHY, ECONOMIC GROWTH, AND POVERTY

The Lao PDR is a sparsely populated, landlocked country in mainland Southeast Asia. The term "small" is frequently used to describe it, although at 236,000 square kilometres, it is about the same size as Great Britain. It shares borders with Cambodia, China, Myanmar, Thailand, and Vietnam, which are, with the exception of Cambodia, vastly larger than it. Despite steady economic growth over the past two decades, it is still one of the poorest countries in the world and ranked 130 on the United Nations Human Development Index in 2007/08. Per capita income in 2007 was estimated at $620. The limited development of the economy reflects its earlier neglected status within the French Indo-China Empire as well as its three-decades-long involvement in both the French and American phases of the Indo-China war.

The size of the Lao PDR population in comparison to its geographic size is small. The total population in 2005 was 5.62 million, growing at a rapid rate of 2.1 per cent per annum. The population of the Lao PDR is young, with more than 44 per cent of the population under the age of 15. Given the youthful age structure, the population will continue to grow substantially for some years. Fertility has however declined rapidly over the past decade and the total fertility rate is currently around 4.5 compared to 5 in 1995 and 6 in 1990. There are however major regional differences in fertility rates with rates being highest in remote rural areas. Life expectancy has increased from about 49 years in 1990 to 56 years in 2005.

Population density is estimated at 25 per square kilometre, one of the lowest in Asia. Approximately 27 per cent of the population live in urban

areas but the vast majority still live in over 10,000 villages where subsistence agriculture is still pervasive. Approximately half of the total population resides in three lowland provinces: Vientiane, Savanakhet, and Champassak. Urban growth is strong due to in-migration as well as natural population growth.

Aside from small size, rapid rates of growth, and low population density, the main feature of Lao demography is its extreme heterogeneity. The country is ethnically diverse with 49 officially-recognized ethnic groups, each with their own customs and languages. Ethnicity is widely categorized in terms of four major ethno-lingusitic families: Lao-Tai (65 per cent), Austro-Asiatic (22 per cent), Hmong-yu Mien (9 per cent), and Sino-Tibetan (3 per cent). Within each family there are numerous subgroups. Human capital development levels within this diverse population differ considerably. The literacy rate for the population aged 15 and over among the Lao-Tai group is 84 per cent compared to 49 per cent for non Lao-Tai groups (National Statistical Centre 2005).[2]

The demographic structure of the Lao PDR creates several major problems for the development of education. The rapidly growing population means that substantial resources will be required merely to maintain existing education standards, even without further expansion and qualitative improvements. As noted earlier, the population is both small and dispersed. Geographic conditions, poor infrastructure, and the limited number of urban centres reduce the opportunities for scale economies and contribute to high unit costs of education. Further, the size and distribution of the population in conjunction with scarce financial and technical resources bring into sharp relief trade-offs between efficiency in provision of services and equitable access to these services. The extreme heterogeneity of the population in terms of language and cultural practices also complicates the delivery of education services. Provision of education services to all groups within the country is a political and economic imperative which is complicated by the size of non-Lao-Tai ethnic groups as well as past neglect. Many of these groups require native-language speaking teachers and tailor-made curricula, both of which are however in limited supply.

The Government of the Lao PDR adopted a centrally planned, command economy system immediately following the end of the war in 1975. Disappointing results as well as reforms in other centrally planned economies induced the Fourth Party Congress to adopt the New Economic Mechanism (NEM) in late 1986. Restrictions on private sector enterprises were eased, prices and trade of goods and services were liberalized, and a number of state-owned enterprises were privatized. Large-scale assistance from western countries and global and regional financial institutions such as the

International Monetary Fund (IMF) and World Bank was sought. Economic growth in the years since the adoption of the NEM has been steady and positive except for a brief period following the 1997 Asian financial crisis. After growing at an annual average rate of 6.98 per cent between 1993 and 1997, the growth rate plunged to 4 per cent in 1998. The exchange rate collapsed from about 1,260 kip to the dollar in 1997 to 7,846 kip per dollar in 2000. Inflation soared to 87 per cent in 1998 and 135 per cent in 1999. The impact on the real incomes of civil servants, including teachers with fixed nominal incomes, was particularly severe. The adoption of a stabilization programme since 2000 and implementation of several reform programmes in public expenditure management, banking, state-owned enterprises, and trade contributed to this improvement.

Economic performance in the present decade has been noteworthy and gross domestic product (GDP) grew at an average annual rate of 6.24 per cent in the 2001–05 period despite challenges such as SARS and the avian flu epidemic, droughts, and floods. The economy grew strongly by 8.3 per cent in 2006, 7.8 per cent in 2007, and 7.2 per cent in 2008. Factors underlying this strong growth were large foreign investment inflows in the mining sector, high commodity prices, strong hydropower sales, and increased receipts from tourism as well as large amounts of official development assistance (ODA) inflows. The country received an average of $323 million per year in foreign aid in the 2000–06 period, an extremely large amount given the size of the population. Aid is essential for meeting budget deficits and funding capital expenditures. In 2006 approximately 40 per cent of ODA was used for social sector projects (OECD 2008). Expansion of non-traditional exports such as garments and coffee has also contributed significantly to growth and employment generation. Rapid growth over the past decade has led to a reduced share of agricultural activities in total GDP as well as an increase in per capita income to about $630 in 2007. Although three quarters of the total labour force is still employed by the agriculture sector, the pace of development as well as the development paradigm being utilized by the government means that the country is at present the most integrated it has ever been with the world economy. The integration is reinforced by its participation in several forums for regional cooperation such as ASEAN and the Greater Mekong Subregion programme under which land transport connections to neighbouring countries have been significantly expanded.

The objective of alleviating poverty has been at the base of every development effort undertaken by the Lao PDR over the last thirty years. The government has been implementing specific poverty eradication measures since 1996 when the Sixth Party Congress defined its long-term development

objective as freeing the country from the status of a LDC by 2020. The development strategies to achieve this goal were articulated in the Fifth National Socio Economic Development Plan and later in the National Growth and Poverty Eradication Strategy which was adopted in October 2003. One of the approaches adopted was a focus on geographic areas where poverty was particularly serious. The Prime Minister's Decree No. 10 identified 72 poor districts (out of a total of 142) of which 47 were designated as "priority areas". Almost one fifth of the national population is included in these 47 priority areas. The most commonly cited problems causing poverty are limited access to land, lack of investment resources for rice production, livestock reduction, natural disasters, environmental degradation, and the lack of water (Chamberlain 2007).

Poverty has been substantially reduced in the past decade. Poverty as measured by the headcount index declined from 45 per cent in 1992 to 39 per cent in 1997 and 33 per cent (approximately 1.8 million) in 2002. Despite a rapidly growing population, the government was able to lift one-eighth of the population out of poverty. Poverty incidence is estimated at 28 per cent as of 2008 (ADB 2009). Poverty incidence has declined in all parts of the country with Vientiane municipality having the lowest level: 16.7 per cent. The country is generally self sufficient in rice, the staple food, although seasonal rice shortages may still occur, particularly in the more remote areas as a result of poor transport and storage facilities. Factors contributing to the reduction in poverty include rapid economic growth, ample foreign assistance as well as market reforms which have increased rice production, development of the private sector and small and medium enterprises and new industries such as garments and tourism which have generated employment opportunities.

The incidence of poverty is closely connected to geographical and ethnic issues. Poverty incidence in 2005 was 20 per cent in urban areas but almost double in rural areas (38 per cent). Poverty incidence among the Lao-Tai group is 25 per cent but for the Mon-Khmer, Hmong-yu Mien, and Sino Tibetan groups is 54 per cent, 40 per cent, and 46 per cent respectively (World Bank 2006). The incidence of poverty also differs by altitude, with poverty incidence in the uplands being 44 per cent compared to just 28 per cent in the lowland areas. As in the past, remoteness and difficulty in accessing basic infrastructure are key determinants of the regional distribution of poverty. The predominance of subsistence agriculture and resulting poverty also reflects very limited opportunities for alternative employment. Widespread income poverty makes many social services unaffordable while geographical isolation and poor infrastructure limits physical access. Language and cultural barriers further reduce access to social services for many groups. Adult illiteracy is

still substantial, with 27 per cent of the population over 15 being illiterate. Almost 60 per cent of the population has not completed primary education (NSC 2005). Widespread poverty limits effective demand for education while poor human capital development limits sustainable growth and poverty alleviation. An outstanding challenge for the Lao Government therefore is to alleviate the poverty of these groups, for which purposes rapid economic growth alone may not be sufficient.[3]

EDUCATION SECTOR

At the end of the French colonial era in 1955, except for a tiny minority who had been educated abroad, most Laotians had either poor or virtually no education. A higher education system did not exist beyond the high school level, while access to lower levels of education was restricted to major urban areas. Subsequent years of widespread armed conflict prevented further progress in the education sector. Successive governments since 1975 have given major importance to the education sector although policy has evolved over time. Policy in the 1975–85 era focused on quantitative expansion. In the 1986–90 period the focus shifted to quality enhancement (Thant and Vokes 1997). The Education Strategic Vision up to the Year 2020 which was prepared in October 2000 provided a general directive for the development of education from 2000 to 2020. It emphasized the need to focus on access and improvement in developing natural and human resources. Critical elements of the vision contained in this document include universal quality education, eradication of illiteracy, expansion of vocational education and training of skilled workers.[4]

The Strategic Vision was followed in August 2001 by the Education Strategic Plan which provided the overall targets to be achieved under the five-year planning process as well as a development framework that relies on three pillars: (1) improving equity and access, (2) improving quality and relevance, and (3) improving administration and management. The Sixth Socioeconomic Development Plan (2006–10) identifies education as one of the four pillars of its poverty reduction strategy.

A road map for achieving targets is provided by the Education For All (EFA) National Plan of Action 2003–2015 which was officially adopted in late 2004. The EFA plan provided the framework for education development and considers six dimensions for intervention: (1) expansion of early childhood care and development activities, (2) universal access to and completion of primary education, (3) improvement in learning achievement, (4) reduction of adult illiteracy, (5) expansion of basic education and training in essential skills,

and (6) increased acquisition by individuals and families of the knowledge and skills required for better living.

The Structure of Education and Progress

The formal education system of Lao PDR consists of general education, technical and vocational education and training, and higher education. Non-formal education is offered predominantly to out-of-school youths and adults. General education consists of preschool for children aged 3–5, primary education of five years of schooling for children aged 6–10, lower secondary education of three years for children aged 11–13, and upper secondary education of three years for children aged 14–16. The medium of instruction throughout the country is Lao which, notwithstanding its importance for national cohesion, may complicate the education of non Lao-Tai groups.

Higher education facilities aside from a medical university and teacher training colleges have become available only in the past two decades. In 1993–94 only 5,281 students were enrolled in higher education and even in 2005–06 there were only 40,115 students at this level. Students are admitted to the National University of Laos, which was established in 1995, after graduating from general secondary education. Students receive bachelor's degrees in four to five years. In 2002 a branch of the University was opened in Champassak and another branch was opened in 2003 in Luang Prabang. In 2007 the faculty of medical science at the National University became a separate university. At present there is high demand for higher education and only a limited number of upper secondary graduates gain access to public university, which explains the rapid expansion of private institutions (ADB 2008). The existing unbalanced representation of non Lao-Tai groups in higher education may eventually be rectified, but in 2005/06, 93 per cent of the students at the National University were Lao Loum, while Lao Theung and Lao Sung accounted for only 5 per cent and 2 per cent respectively (Ogawa 2009). The education sector has made much progress since 1975, reflecting strong political will and availability of ample foreign assistance. According to the Population and Housing Census (NSC 2005), in 2005 the literacy rate of the population aged 15 and over was 73 per cent, with 83 per cent for males and 63 per cent for females. The literacy rate was highest in the capital and lowest in Phongsaly province (43 per cent). Literacy rates also differed considerably among ethnic groups, with literacy rates for non Lao-Tai ethnic groups being only 49 per cent.

Access to education as indicated by enrolment and gross enrolment ratio (GER) and net enrolment ratio (NER) indicators show that progress has been substantial. The number of students enrolled at the primary level increased

from 495,375 in 1984/85 to 891,881 in 2005/06. Lower secondary enrolment increased from 69,226 to 243,131 over the same period, an increase of over 350 per cent. However, it is the increase in upper secondary education that is truly spectacular. The number of students enrolled increased from 20,093 to 147,510 in the same time period. Between 1990 and 2005 the net enrolment ratio for primary education increased from 58 per cent to about 84 per cent. The gross enrolment ratio increased from 22 per cent in 1990 to 52 per cent for lower secondary and from 26 per cent in 2003 to 35 per cent in 2005 for upper secondary (UNESCO 2008).

Gender disparities in education access have also narrowed significantly. In 1992/93 the ratio of girls to boys enrolled in the primary level was 0.82. The same ratio improved to 0.86 in 2002/03. Similar improvement at both lower secondary and upper secondary school levels are seen with the ratio increasing from 0.71 to 0.76 in the former and 0.64 to 0.81 in the latter (World Bank 2006). Discrepancies in both GER and NER indicators exist, with males doing better in primary education in 2005/06. However, NER indicators for female students are higher than for males in both lower secondary and upper secondary education (UNESCO 2008).

Technical and vocational education and training institutions admit students after they complete either grade eight or eleven. Five different types of teacher training of varying complexity are offered, but teachers who wish to teach at upper secondary level need to graduate from the Faculty of Education at the National University of Laos. Non-formal education programmes target three groups: (1) children and young adults aged 6–14 who did not have an opportunity to attend primary school, (2) adults 15–40 who are illiterate, and (3) youths aged 15–24 who do not have definite vocations and are willing to follow basic vocational training.

The recent development of private education facilities following the Prime Minister's Decree on Private Education in 1995 is a noteworthy development. Private schools are growing in number, particularly in major urban areas, and currently 2.4 per cent of primary school students are enrolled in private institutions. Its significance is, however, greater in higher education, where approximately 35 per cent of students (25,958) are enrolled in private institutions, which may reflect an imbalance between the large number of students graduating from upper secondary school and the limited number of openings in the government-owned universities. In 2006–07 there were eighty-three private colleges which currently are not properly regulated and are not required to meet common quality standards (Department of Private Education 2008).

Challenges

Despite the rapid progress of the past two decades the Lao education system faces many problems, but two key challenges which stand out are uneven access and low internal efficiency. Universal access to primary schools remains a major challenge. Approximately 16 per cent of primary school age children are not enrolled in school (UNESCO 2008). National statistics hide disparities in access by geographic region, socio-economic status, gender, and ethnicity at all levels of education. Access to schooling in remote rural regions is limited compared with access in urban areas. The capital city of Vientiane for example has the highest NER of 95 per cent for girls and 92 per cent for boys at the primary level compared to Luang Namtha province which has an NER of 43 per cent for girls and 49 per cent for boys (ADB 2006). Urban areas are associated with higher enrolment rates controlling for other characteristics. Net primary enrolment rates are 76 per cent for Lao-Tai but 99 per cent, 35 per cent, and 47 per cent respectively for Mon-Khmer, Sino-Tibetan, and Hmong-Mien groups. The gap between priority and other areas in provision of education has actually increased since the early nineties. For example, the enrolment rate for children aged 6–10 years in primary school remained at 50 per cent in priority areas but increased from 65 per cent to 70 per cent in the 1992 to 2003 period in other areas. A development divide between ethnic groups by literacy can also be seen. Whereas 93.3 per cent of Lao-Tai males in urban areas were literate in 2002/03, the corresponding figure for non Lao-Tai was only 88.7 per cent. The gap was even more pronounced in rural areas where 81 per cent of Lao-Tai males were literate compared to only 51 per cent for non Lao-Tai (King and van de Walle 2005).

The level of educational attainment also differs by poverty status. In 2002/03 and within the Lao-Tai group, 93.3 per cent of non-poor urban males were literate while only 86.4 per cent of poor urban males were literate. Over 86 per cent of non-poor urban females were literate but only 75.6 per cent of poor urban females were literate. Similar differences between poor and non poor groups can be seen in rural areas as well as among non Lao-Tai groups. Thus, the lowest levels of literacy are found among the poor, rural, Lao-Tai females (49.4 per cent) and poor, rural, non Lao-Tai females (17.1 per cent) (King and van de Walle 2005).

Physical barriers prevent or limit access to education facilities for many. Approximately 15 per cent of villages are still without a primary school within commutable distance. Low population density and remoteness make provision of cost effective and sustainable education services difficult in remote areas.

Even in those cases where schools exist they may be incomplete in that less than five years of schooling is offered. Fifty seven per cent of all primary schools and an estimated 70–80 per cent of schools in the poorest districts do not offer the full five grades of primary education. Consequently a quarter of classes are taught in multigrade settings which have adverse effects on learning outcomes (World Bank 2007*b*). A lack of physical infrastructure such as roads also appears to deter female education. One study shows that primary school NER of girls in villages far from roads is 49 per cent compared to 56 per cent for boys. In contrast the relevant indicator for urban areas is 90.5 per cent for girls and 88 per cent for boys (ADB 2006).

Poor internal efficiency is reflected in high dropout and repetition rates and low learning outcomes. Repetition and dropout rates are high in grades 1 and 2. About 33 per cent of students in primary school repeat grade one and another 19 per cent repeat grade 2. It takes an average of eight years to complete primary education (ADB 2006). However, only about 70 per cent of boys and less than 60 per cent of girls remain in school at the end of grade five (Lao Poverty Assessment 2006). Over 70 per cent of the students who enter lower secondary school and 81 per cent of the students who enter upper secondary school complete the cycle (UNESCO 2008).

Rapid expansion of education with limited financial resources has also had an adverse impact on quality which is reflected in the limited number of qualified teachers, shortages of textbooks, and overcrowding in classrooms. The situation is particularly acute in the lower and upper secondary education levels, where rapid expansion has not been matched by increased availability of schools and facilities and foreign assistance.

The issue of insufficient teachers and substandard teachers lies very close to the heart of the problem of providing quality education and it is one that has "dragged on for years" (National Plan 2006). There is a shortage of primary and lower secondary teachers even though the teacher education institutions have trained enough primary teachers to meet demand. The reasons for the continuing shortage include limitations placed on the quota of new teachers that can be recruited each year, inefficient deployment, and limitations of provincial allocations. Teachers' salaries are low and infrequently paid. Primary school teachers receive about $39 including supplements, with little difference between urban and rural areas. Incentives for teacher performance are too low to act as a motivating force and are not subject to a transparent process (World Bank 2007*b*).

Some progress has been made and in 2006 the average primary teacher salary was close to 1 per cent of GDP per capita (Tibi 2006). Lower secondary teachers' salaries in the 2000–04 period stood at about 0.53 per cent of GDP per capita in comparison to 0.64 per cent and 0.76 per cent respectively in

neighbouring Cambodia and Thailand (UNESCO 2009). Moonlighting by teachers at the expense of their regular job is therefore widespread. The most common form of additional employment is agricultural work that generates on average one third of a teacher's total income (World Bank 2007*b*). The resulting reduction in instructional time, low morale, and high incidence of people leaving the profession are hardly surprising.

Further Challenges

The following section discusses three issues which are likely to have significant influence on the impact of the recent global financial crisis on the Lao education sector.

Demand for Education

The demand for education is not necessarily high or uniform across all parts of the country. Government efforts to date have focused on the supply of education services, with five years of primary education being made compulsory for all children 6–14 years of age since 1996. The demand for higher education in urban areas is very strong as can be seen from the rapid growth of private institutions. Numerous studies have however noted that there can be a lack of interest in education (Lao Poverty 2006). Chamberlain notes that education is regarded as a burden and imposition in some areas. Factors underlying low demand for education include high monetary costs, lack of relevance, parents who do not speak the language of instruction, and long commuting distances (Chamberlain 2007).

Laos may be in the same situation as Thailand was in the mid eighties when people did not press for more post primary education since it did not have any impact on their productivity. Only in urban areas does post primary education have a clear benefit on the chances of employment and tangible increases in productivity, but this accounts for a very small minority (Pongpaichit 1992). This result seems to be corroborated by a recent study which shows that an additional year of schooling yields a 4.5 per cent return in Vientiane and only 2 per cent in other provinces (Onphandala and Suruga 2006). Studies have also suggested the quality/irregular attendance of poorly paid teachers as a factor contributing to low demand.

The situation for non Lao-Tai ethnic groups seems to be even more severe. Chamberlain states that education is not responding to the real need of non-Lao-Tai ethnic groups (Chamberlain 2007). A lack of female teachers for non-Lao-Tai groups may also be responsible for the low enrolment of girls in remote/ethnic areas (UNESCO 2008).

Expenditure on Education

Expenditure on education is generally low. It has fluctuated over time and is greatly dependent on external assistance. Between 1990 and 1997 average annual total public expenditures on education were estimated at about 2.5 per cent of GDP. Expenditures declined sharply in 1997 from 15 per cent of the budget and remained low for some years before gradually increasing again to pre-crisis levels. In 2006/07 education expenditures as a percentage of GDP were 3.2 per cent and as a percentage of total government budget, 15 per cent. National averages however hide regional variation in expenditures and the dependency on external aid for almost all capital expenditures. More than 40 per cent of the budget is allocated to primary education while another 25 per cent is allocated to secondary education.

External assistance is absolutely critical to the education sector. Funding agencies contribute on average approximately 95 per cent of capital investment in education. In 2004–05 ODA disbursement for the education and human resource development sector was $53 million (14 per cent of the total amount) of which $37 million came from ten bilateral donors (UNESCO 2008). These investments however create a demand for recurrent expenditures that the government has not been able to meet. Increasing capital investments without matching provision for recurrent costs result in new schools which are chronically short of teachers, textbooks, learning materials, and other supplies. The limited education expenditures also lead to the situation of teachers being paid very poorly: 0.65 per cent of GDP per capita compared with a regional average of 2 to 2.5 per cent GDP (ADB 2006) although salaries take up the bulk of expenditures: 83 per cent in 2004–05 (World Bank 2007*b*). Extreme dependence on external financing also exposes the education sector to fluctuations in the value of contributions which vary with exchange rate movements and the economic welfare of some donor countries whose ODA contributions are set to a fixed proportion of GDP.

Decentralization of Education

The devolution of planning and administrative functions was initiated in the late 1980s, based on the rationale that central authorities knew less about local realities and conditions than provincial authorities.[5] Following this, the responsibility for financial education became primarily that of provinces and districts which possess their own revenue base and negotiate their budgets directly with the Ministry of Finance.

However, decentralization and devolution of authority did not work as intended as a result of the shortage of trained manpower and materials at the

lower levels of administration as well as the lack of coordination, information, and legal guidelines to enforce national guidelines. Provinces frequently set their own priorities which were not always consistent with national policies, while weak resource mobilization capabilities led to situations in which provinces were increasingly unable to devote sufficient resources for basic social services (Thant and Vokes 1997).

More recently Phetsiriseng (2009) has listed five constraints on decentralization in Lao education: (1) lack of reliable data; (2) lack of clearly defined functions at central, provincial, and district level; (3) poor staff capacity; (4) conflicting lines of decision making and coordination at different levels; and (5) insufficient resources. Notwithstanding these problems, the central government has continued the process of steadily devolving decision making and financial management powers to the provinces, districts, and villages, supported by the Prime Minister's Decree on Decentralization. Provincial governments currently have a high degree of autonomy over resources and expenditures.

The Ministry of Education has since 2000 shared responsibilities with the Provincial Education Services and the District Education Bureaus (UNESCO 2008). Decentralized management covers planning, budgeting, personnel issues, management of property, and academic and technical management. Although the government specifies budget guidelines, in practice, the final decision rests with provincial governors who may allocate their budget according to perceived needs and priorities. In the 2003–06 period the share of provincial budgets allocated to education varied from a low of 5 per cent to a high of 25 per cent. Compounding the vagaries in budgetary allocation emanating from the considerable discretionary power that provincial governors yield is the fact that provincial governments do not in general have the planning and management capacity to relate education objectives to resources or to monitor the benefits or impact of expenditures (Tibi 2006). It is not quite clear how such a system can give assurance that nationwide objectives will be met. Decentralization processes also have limited provision for the redistribution of resources which leaves poorer provinces at a disadvantage and exacerbate regional disparities (ADB 2006).

IMPACT ON THE LAO ECONOMY AND EDUCATION

Vulnerability of the Lao Economy

In a little over a year the sub-prime mortgage problem which started in mid-2007 in the United States had developed into a global economic crisis and pushed the global economy into recession. At the beginning of 2009,

the world economy was mired in the most severe financial crisis since the Great Depression, with no clear sign as to when recovery would occur. The global recession confronts developing countries such as the Lao PDR with two basic questions: (1) will they be immune from the global recession and (2) will it have an impact on social sectors such as education. The following sections address each question in turn.

Immunity from the global recession for the Lao PDR was a popular belief in some quarters especially in the earlier parts of the crisis. Underlying this optimism was the notion of Asia decoupling from the world economy. After the 1997–98 Asian financial crisis, developing countries had learned to avoid risks and, by choosing the right policies, had "decoupled" themselves from troubles in other parts of the world and effectively insulated themselves from global problems. Many Asian countries had accumulated large reserves, switched to long term and domestic currency borrowing, and reduced fiscal and current account deficits (Ravallion 2008). Furthermore, balance sheets had been strengthened through improved bank supervision and corporate governance and risk management efforts by the private sector.

Decoupling was even more likely in countries such as the Lao PDR which had self-sufficient economies and limited participation in global financial markets. Perhaps this is what Bounthy Sisounphanvathong, Deputy Minister of Planning and Investment, meant when he stated that the impact of the crisis on the Lao economy would not be as serious as that of the 1997/98 Asian financial crisis. An additional source for optimism in the Lao PDR was the fact that the Nam Theun 2 hydroelectric dam would soon start operating and the first installment of an expected $2 billion revenue stream over a twenty-five-year period would flow to the country in 2009 (EIU 2008). Some optimism may also be based on the short duration of the 1997 Asian financial crisis, limited exposure to financial markets, and confidence in the strength of traditional, household, community, and religious, coping mechanisms.

One year into the recession there is considerably less support for believing that the Lao PDR and similar countries will be entirely immune from the global crisis. Developing countries will be significantly if indirectly affected by changes in trade, investment, and remittance flows. The vulnerability of the Lao PDR to global economic problems is reflected in the following transmission paths which were largely unknown a decade earlier and are the result of the structural changes in the economy and greater integration with the global economy.

First, the Lao PDR is dependent on a few key export commodities, many of which are facing declining demand or falling prices, e.g., coffee, maize,

rubber. Garment exports expanded very strongly from 21 million pieces in 1999 to 68 million pieces in 2006, and the industry employs 27,000 or over 20 per cent of the total urban labour force. Exports amounted to $189 million in 2008, but the industry is vulnerable to shortages of skilled labour, low productivity, competition from other Asian economies, and an uncompetitive exchange rate as well as uncertain global demand.

Second, Lao trade links are concentrated in a few markets, all of which are to some degree affected by the current economic crisis. Half of total exports in 2007 were to Thailand and another 25 per cent went to Vietnam and China. During the same period approximately 70 per cent of imports were from Thailand and 14 per cent were from Vietnam and China. Laos is therefore extremely vulnerable to economic slowdown in its neighbouring countries, which seems highly likely.

Third, rapid growth in recent years has been based on the export of minerals such as gold and copper. The country was fortunate in that the completion of new mines coincided with the most marked commodity price boom of the past century in terms of magnitude and duration (World Bank 2008). Exports of gold and copper represented 50 per cent of total exports in 2007. The Sepon mine alone generated $115 million in 2007 from taxes, rental fees, and royalties. The commodity boom came abruptly to an end in 2008 and world copper prices dropped from $8,000 per ton to below $4,000 per ton in November 2008 leaving a huge shortfall in revenue and putting near term investments in mining in doubt (EIU 2008). Lower than budgeted tax collection from the mining sector places fiscal revenues under strain (IMF 2009). Workers have also been laid off from mines.

Fourth, tourism receipts are likely to decline substantially during the recession. In 1990 there were only 14,400 tourists, but the industry has grown rapidly and 1.2 million tourists were reported in 2006, 55 per cent from Thailand and 15 per cent from Vietnam. Tourism became the biggest single foreign exchange earner in 2007 (over $200 million), but the economic crisis is likely to halt the growth of the industry, at least in the short run. The worst effects are likely to be felt in major urban areas and border regions.

Fifth, foreign direct investment (FDI) has been a key driver of Lao economic growth over the past decade. FDI inflows in the 2004–07 period averaged close to $600 million per year (ADB 2009). FDI came primarily from neighbouring countries (Thailand 23 per cent, Vietnam 13.5 per cent, and China 12.8 per cent in the 2000–06 period (U.S. Embassy 2006). Since 80 per cent of the investment is for the hydroelectric and mining sectors, individual projects tend to be very large and delays in project financing have an exaggerated impact on the Lao economy. In late 2008 the local media

reported that three projects were being suspended due to difficulty in securing financing, reduced demand from Thailand, and the Lao Government's desire to review its power purchase agreement with Thailand (*Vientiane Times*, 17 December 2008). Delays in these projects mean the effects of the economic crisis will not be short lived.

Sixth, remittances from external as well as internal migration are important but are likely to decline, adversely affecting household incomes and threatening the gains made in poverty alleviation in the recent past. Within the country migration has increased as a result of better jobs and improved transport networks and education opportunities. Migration is mostly to the capital and provincial cities from the mountainous areas in the northeast and central part of the country. Slower economic growth in formal sector economic enterprises may reduce migration rates and the amount of remittances.

Internal migration is overshadowed by external migration which is primarily to neighbouring Thailand. Worker registration in Thailand in 2004 showed 99,932 migrants from the Lao PDR, which does not include seasonal migrants, dependents, or illegal workers; the actual number is thought to be twice this.[6] Remittance amounts are probably between $40 and 100 million per year (World Bank 2006). Any reduction in remittances, either as a result of unemployment in a slow-growing Thailand or of repatriation, can have a severe impact on the Lao PDR. A 2003 survey of 6,000 households revealed that 87 per cent of migrants came from the lowest income quintile, while other studies have shown that remittances are an important part of household incomes, especially when pooled with other income (World Bank 2006). Given that most migrants are from the Lao-Tai ethnic group, any slowdown in migration/remittances will have geographical/ethnic ramifications in addition to an increase in poverty. The government expected 14,000 Laotians to be laid off in Thailand in 2009 (Voice of America, 15 February 2009).

The foregoing suggests that despite earlier expressions to the contrary, the global recession will affect the Lao PDR, and the country should expect lower growth rates in 2009 and 2010 in sharp contrast to the 7.4 per cent average growth rate achieved in the 2004–08 period. The government announced in early 2009 that 48,000 jobs had already been lost and that further unemployment was expected (Voice of America, 15 February 2009). Both private and public expenditure on education are also likely to decline. Reductions in financial revenues reflecting lower resource revenues, import taxes, and other export receipts will affect the amount of government funds available for the education sector. Real expenditure on education may consequently be reduced as happened during the 1997 Asian financial

crisis when the Lao education budget declined, as it also did in Thailand. The recession will however not affect all parts of the economy or the entire population equally.

The Lao PDR in many senses is still striving to create a national identity but, despite strenuous government efforts, there are divides along place of residence (urban/rural, lowland/upland) and ethnicity and between market and subsistence economies (Jerndal and Rigg 1998). The segments of the populace most likely to be affected by the current crisis are the urban poor engaged in the formal economy and those who depend on remittances. For these groups household incomes may decline substantially as a result of declines in real wages, an increase in unemployment, and reductions in remittances. There may also be a shift from the formal sector to the informal sector which provides little if any social protection benefits. Farming households engaged in the production of major export crops may also be affected, although access to land resources and food may substantially compensate for any shortfall in cash income. Remote populations engaged primarily in subsistence agriculture may also not be immune to the recession, although the effects of the economic crisis will be transmitted through reduced public expenditures on education rather than through any substantial decline in household income.

The impact of reduced private and public expenditures on education will be amplified through the unique problems of the Lao education sector touched on earlier. Demand for education, which is not high to begin with among some communities, is likely to decline even further in the face of reduced household incomes and supply constraints. Public expenditure, which has been consistently low even during times of high rates of economic growth, can be expected to decline unless conscious efforts are made to maintain expenditure levels. Decentralization may allow provincial authorities to ignore national education policies or concentrate on other objectives, particularly if the choice is perceived to be between provincial economic growth and education objectives.

Reduced expenditures, both public and private, present further challenges to the Lao education sector in terms of efficiency, equity, and long-term sustainability. The existing tendency to enrol in school late and withdraw from school without completing the full five years of primary education will be reinforced by reductions in household incomes. Limited public expenditure will further threaten the quality of education, particularly in upper secondary school where enrolments have rapidly expanded with little complementary improvement in facilities.

The effects of the crisis on access to education will not be distributed equally. The urban poor are likely to feel it more keenly than the rural poor who are less well integrated into the market economy. Women may be disproportionately affected by the crisis since females dominate the lower segments of global garment supply chains and are likely to be the first to be made redundant.[7]

The negative effect on women may also be more pronounced if, as in Indonesia during the 1997 crisis, dropout rates are higher for female students than for male students. The potential for the economic crisis to affect female education was highlighted by a recent study which found that girls' schooling is generally more precarious and more responsive to costs and conditions of schooling and socio-economic and demographic conditions faced by households. Boys who do not enter school by the age of 9–11 are still likely to do so at some point, while girls are unlikely to. Girls from minority groups are less likely to be in school than those from Lao-Tai groups compared to boys from the same groups. Having a complete multigrade school in the village of residence also had a much larger effect for girls than for boys (King and van de Walle 2005). In extreme cases, increased dropouts may be accompanied by increased child labour.

Reduced expenditures will also have long term and irreversible effects if children who drop out do not return to school even when economic conditions permit, thereby jeopardizing the government's goal of graduating from LDC (least developed country) status by 2020. The way in which different regions are affected by and respond to reduced availability of public resources for education will have a long-term influence on the task of nation building and cohesion.

What is to be Done?

Education sector achievements over the past two decades need to be protected and nurtured if the Lao PDR is to achieve its objective of graduating from LDC status by 2020. Education is key to improving labour productivity and competitiveness in a global economy. The nature of the responses required is, however, less obvious given the uncertainty surrounding the duration and depth of the crisis as well as the effect of the crisis on the education sector. Historical experience is also of somewhat limited use since the 1997–98 Asian financial crisis largely affected more developed countries rather than low income, transitional countries like Laos. Suggested responses are therefore necessarily very tentative although a few basic ideas can be discussed with some confidence even now.

A key principle that should be observed is of "doing no harm", which in this context implies ensuring macroeconomic stability and concentrating on reviving economic growth which will enable poverty reduction efforts. During the 1997–98 crisis, well-meaning policies aimed at achieving food self sufficiency led to extra budgetary expenditures through rapid monetary expansion which further eroded confidence and accelerated the collapse of the domestic currency. The ensuing triple-digit inflation reduced real incomes for large numbers of people and forced changes in consumption and savings patterns (Okonjo-Iwela et al. 1999). The macroeconomic situation in 2009 was much better than at the time of the Asian financial crisis in terms of fiscal space, debt service ratio, and inflation as well as capacity to manage. A fiscal stimulus on the back of the significant domestic demand and momentum built up in this decade could therefore be considered. Fiscal stimulus should be aimed at two separate although related issues: reviving growth and generating employment opportunities, and maintaining and strengthening human capital investments.[8]

Policymakers should focus on protecting that which is already achieved by maintaining expenditure levels. A conscious effort will be required to avoid a recurrence of the situation in 1997–98 when expenditures were reduced and projects delayed or postponed due to lack of counterpart funds. As a result of recent public expenditure reforms, the Lao PDR has the fiscal space for expansionary programmes. The government budget deficit improved from over 5 per cent of GDP in 2003 to about 3 per cent in 2008 (World Bank 2009). Measures to ensure that public revenue from minerals and hydropower sales are adequately invested in human capital should be implemented.

The process of decentralization should be objectively reassessed. Countries with strong local governance may use decentralized structures to quickly implement local projects, but that does not hold true in the Lao PDR where lower level capacity is both uneven and limited. Poorly implemented decentralization at a time of economic crisis and general shortages of resources may exacerbate regional disparities and hinder the achievement of national goals and objectives. Pragmatic flexibility in dealing with this concept, which has a long and vacillating history in the country, is required.

Lao policymakers can also examine the responses of other Asian countries during the 1997 crisis to consider adopting appropriate and fiscally responsible social protection programmes. Thailand for example borrowed from the Asian Development Bank (ADB) to make loans available to 100,000 children from families with annual incomes of less than 300,000 baht. Loans were also utilized to provide scholarships for 200,000 primary and lower secondary students. Indonesia, through loans from the World Bank and ADB, provided

scholarships and block grants to schools in poor districts and certificates for tuition reduction (Knowles 1999).[9] Conditional cash transfers to ensure students are not withdrawn from school due to adverse effects of the economic crisis on households are also worth examining, although they may be complex to administer, may leave out the poorest who are the least able to comply with conditions, and require a secure system of transferring cash (Freeland 2007). Scholarship programmes have been successful in improving attendance rates in Cambodia, particularly among disadvantaged girls, and could be considered in Laos as well (Filmer and Schady 2008).

Given the largely concessionary nature of Lao borrowing as well a favourable debt service ratio, external borrowing to maintain education expenditures is an option for the Lao Government. Policy responses however need to be quick to implement disbursements and, wherever possible, built upon existing programmes. They should also take the maximum advantage of and build on existing traditional coping mechanisms within households, communities, and religious organizations. Responses should support public expenditure to protect those in need as well as transfer resources to households. Equally important is the need for appropriate targeting by area, income groups, or gender (Knowles 1999). Targeting has the potential to increase transfers to the poor and is particularly important in the Lao PDR where poverty/education linkages are complex. Targeting however brings with it its own set of costs and benefits. Costs include the inadvertent exclusion of some needy groups, high administrative costs, costly testing mechanisms, and possibly heightened social tensions (Hoddinott 2007).[10]

Factors which explain enrolment differ across subgroups by gender, urban and rural residence, and ethno-linguistic affiliation. Policy interventions will not succeed unless they are carefully tailored to the specific constraints and needs facing each group (King and van de Walle 2005). Targeted interventions will however necessitate increased investment in information systems which can monitor the impact of the crisis on budgets, enrolments, and poverty levels and enable the design and evaluation of interventions.

SUMMARY AND CONCLUSIONS

The Lao PDR has achieved a significant amount of economic progress since the NEM was first adopted in 1986. Poverty levels, while still high, have been brought down significantly, and access to at least basic education is now a reality throughout the whole country. The recent global financial crisis however threatens the progress that has been steadily achieved, even though the country has weathered it better than many countries in the

region. Decoupling from the larger world economy is not possible, and the economic crisis is being transmitted to Laos in several different ways. Economic growth will decline in the short run, poverty will increase, and some groups will be affected more than others. Public and private expenditures on education are also likely to decline. The crisis may have adverse effects on the education sector in terms of efficiency, equity, and long term sustainability. These challenges come on top of existing ones which include providing for an increase in the number of school children, improving school completion rates, and expanding education to disadvantaged groups. The relevance of education also must be improved in order to increase the demand for it, particularly by non Lao-Tai groups. Government expenditures, which have only recently reached their pre-1997 levels, must be further increased if the government is to attain its stated sectoral goals. Funds need to be found to deliver these services as well as match aid-funded capital expenditures.

Effective policy responses are clearly needed since education is the key to improved labour productivity and global competitiveness. It is essential that the country not lose the human capital built up over the past twenty years, since it will become more integrated into the regional economy and its competitiveness will depend increasingly on labour productivity rather than low labour costs. In the longer term, investment in education is Laos' prime guarantee for reducing poverty. The design of appropriate responses is however surrounded by a large amount of uncertainty, although some basic ideas are discernible even now. The government needs to observe the principle of "do no harm". Counter-cyclical policies need to explicitly address the sources and transmission path of factors which have caused the Lao economy to slow down. Education expenditures, low even at the best of times, should also be maintained. Due to recent reforms the government has sufficient fiscal space and room for a mild expansionary policy. The long term needs of national cohesion and growth should also induce the government to re-examine the wisdom of decentralization of education budgets and functions.

Many different types of social protection programmes which transfer resources to households in order to maintain education facilities and ensure their use exist or have been used in Asia in the past. Policymakers need to carefully evaluate the performance of different policies and programmes and adopt those which can be fast disbursing and targeted to address the multidimensional linkages between education and poverty in the Lao PDR. Cyclical downturns are an integral part of the development paradigm the government has adopted, and preparing for such downturns and minimizing the social costs they bring with them is merely basic good governance.

The government needs to take leadership in proactively implementing social protection systems, including those directly relating to education.

Notes

1. The opinions contained in this chapter are those of the author only. The capable assistance of Kristine S. Busson and Cecile Sarfati in the preparation of this chapter is greatly appreciated. The usual disclaimers apply.
2. Lao-Tai are sometimes referred to as Tai Kadai, while Austro Asiatic are sometimes referred to as Mon Khmer. Within each of the four major linguistic groups there are many subgroups: Lao-Tai (8), Austro Asiatic (32), Hmong-Yu Mien (2), and Sino Tibetan (7). This classification replaces the earlier one under which indigenous ethnic groups are put into three general categories that reflect traditional residence patterns and cultural origins: Lao Loum (lowland), Lao Theung (midland), and Lao Sung (highland). The Lao Loum are roughly equivalent to the Lao Tai under the current classification system, while the Lao Sung are roughly equivalent to the Hmong-Yu Mien. See Thant and Vokes (1997).
3. Sustained growth and poverty alleviation have been accompanied by increased income inequality which may hinder further poverty alleviation efforts. Income inequality as measured by Gini coefficient increased from 30.4 to 34.68 over the 1992–2002 period. The annualized growth rate of 1.32 per cent was the sixth highest out of 21 Asian countries for which data are available. Similarly the ratio of expenditures/incomes of the top 20 per cent to bottom 20 per cent increased from 4.27 to 5.4 over the same period. See Asian Development Bank (2007).
4. For a discussion of Lao education issues in the 1975–96 period, see Thant and Vokes (1997). Many of the issues are depressingly familiar.
5. For an early discussion on the decentralization debate, see the relevant chapters in Brooks and Thant (1998).
6. Phetsiriseng (2009) reports Thai Government registration of 181,614 for the same year, of which slightly more than half are female. He also notes that the out-migration of young people has created more problems than it has solved. This is an issue which undoubtedly deserves more attention.
7. Women can also be affected by a reduction in the amount of microfinance capital available and lack of access to counter-cyclical interventions. The burden of the shock may also be disproportionately borne through an increase in unpaid care work within the household.
8. A stimulus package of sorts was however assembled by the first quarter of 2009. Profit taxes were reduced, credit, particularly to agriculture, was extended, visa fees were reduced, and power tariffs for mining companies were also reduced (VoA, 16 March 2009). The government has also received pledges of assistance from the ADB and World Bank (Asian Development Bank 2009).

9. Social protection consists of five major components: (1) active and passive labour market programmes, (2) micro and area-based schemes, (3) child protection, (4) social insurance programmes, and (5) social assistance and welfare schemes which are intended for the most vulnerable groups with no other means of adequate support. The last component includes cash or in kind transfer and temporary subsidies.
10. Engrall (2006) states that for multi-ethnic poverty reduction, both broad policies as well as tailored policies which recognize that there are large differences in the ability to make efficient use of available resources between ethnic groups are needed.

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5

REGIONAL DISPARITIES, INCOME INEQUALITY, AND POVERTY
A Cumulative Causation from Malaysia's Experience

Asan Ali Golam Hassan and
Muszafarshah Mohd Mustafa

Changes in economic structure are normally associated with an economy's transformation from an emphasis on agriculture to a more modern, more urbanized, and more industrially diverse manufacturing and services economy. Structural change refers to the relative importance of sectors in the economy such as production and factor use, increases in the rate of accumulation, shifts in the sectoral composition of economic activities (industrialization) focusing initially on the allocation of employment, change in location of economic activities (urbanization) and accompanying demographic transition, decreasing poverty, and inequality in income distribution.

Income inequality and regional disparity happen because of uneven structural change occurring at the same time in different regions. Each region often experiences different patterns of economic and demographic structural changes as well as differences in concentration of population, investment, manufacturing products, labour productivity, and job creation. The levels of regional income have strong linkages with the establishment of the manufacturing sector. Since independence and subsequently after the

implementation of the New Economic Policy (NEP)[1] in 1971, the Malaysian Government has made serious efforts to decentralize manufacturing activities. This is because industrial imbalance has an important relation to the imbalance of household's monthly income, poverty, and unemployment.

Production sources, especially natural resources, capital, and labour, are imperfectly scattered. Many economic activities are concentrated in particular regions, where such regions are an important source of international specialization and trade (Krugman 1999). Uneven regional growth and distribution in the process of structural change are affected by three key factors: firstly, natural resource advantages (imperfect factor mobility), secondly, economies of concentration (imperfect divisibility), and finally, transport and communication (imperfect mobility of goods and services) (Hoover and Giarratani 1999).

Although a study by the World Bank showed that newly industrializing countries, which have rapid export growth and economic growth, have significantly reduced absolute poverty, improved human welfare, and reduced the inequality of income distribution during the thirty years before the onset of the financial crisis in the middle of 1997 (World Bank 1993; Nakao 1997; Ishak 2000), it did not show how this rapid growth creates inequality of economic growth among regions in that particular country. In other words, the general relationship between economic growth and poverty reduction is clear: growth will decrease poverty (World Bank 2001, p. 52). However, rapid growth did not occur in all regions but was restricted to manufacturing-based regions. Thus, regional equality has to be sacrificed to promote maximum national growth by concentrating resources in the most competitive regions (or growth centres), although at the same time governments try to decrease regional and income inequality.

Most of the imported capital (foreign direct investment; FDI) for promoting growth was concentrated in export products. In other words, international factors (FDI and export products) can have strong linkages to regional growth and disparities. At the same time, the location of FDI inflows to a developing country is related to several factors. These include a large domestic market, faster economic growth, higher per capita income, higher level of existing FDI stock, a more liberalized (open) trade regime, higher efficiency wages, and remoteness from the rest of the world (Chunlai 1997*a*, 1997*b*). All of these factors are positively related to FDI inflows, except for remoteness which is negatively related.

Efficiency wages are wages above the market level. Firms that offer higher efficiency wages will attract talented and productive workers to their organizations. In developing and less developed countries, many multinational

companies are able to offer higher efficiency wages to their workers. These firms tend to concentrate in high growth industries and have the benefits of economies of scale. Those industries have the ability to attract FDI and promote economic growth. Remoteness tends to be negatively related to FDI. This is due to the fact that a remote region usually has a low density of economic activities. At the same time, a remote region is far from other cities, towns or ports, and thus incurs higher transportation costs when exporting goods. Low density and higher transportation costs would discourage investors from investing in the region.

In general, most of this comparative advantage was located in developed regions and this led to widening gaps between regions. Hence, without government intervention, income inequality will get worse in the early process of industrialization and will become better when internal and external diseconomies of urbanization (concentration) take place.

REGIONAL DISPARITIES, INCOME INEQUALITY, AND POVERTY

Malaysia comprises two parts: Peninsular Malaysia (also known as West Malaysia) and East Malaysia (situated on the Borneo Island). Being colonized by the British for the period of 172 years has resulted in a dualist economy in Peninsular Malaysia. Transportation investment under the British was highly dependent upon the "growth capacity of the region" (Leinbach 1975). The British strategy was based on the so-called "building upon the best" and this initiated the origins of contemporary regional imbalanced growth in Malaysia (Jomo and Ishak 1986). The economic dualism inherited from colonialism continued after independence in 1957. In some aspects, the dualist economic phenomenon became worse. This dualist phenomenon can be divided into three categories: location (urban-rural); economic activities (modern-traditional); ethnicity (Malay, non-Malay). The groupings of economic activities can also provide a picture of the structure of average incomes of workers. High income is usually referred to as the modern urban sector, medium income is referred to as the modern rural and government sectors, while low income is referred to as the traditional urban and traditional rural sectors. In terms of regional income levels, most of the traditional rural sector was focused in the low-income states. The modern rural sector and traditional urban sector were concentrated in the medium income states, while the modern urban sector was concentrated in the high-income states (Table 5.1).

Generally, before and in the 1970s, the high level of the average income of workers was about one and a half to two times that of the medium level

TABLE 5.1
Distribution of GDP by Origin, 1967 (%)

	Agriculture	*Modern Agriculture*	*Traditional Agriculture*	*Mining*	*Manufacturing*	*Commerce*	*Service*	*Others*
High income states								
Selangor	11.6	*7.6*	*4.0*	6.2	19.9	21.9	19.6	20.8
Penang	15.7	*5.4*	*10.3*	—	12.2	22.0	27.6	22.5
Perak	26.2	*11.6*	*14.4*	18.2	6.8	16.5	20.7	11.6
Median income states								
Johor	40.7	*27.4*	*13.3*	2.0	10.1	14.1	22.8	10.3
Malacca	33.5	*26.7*	*6.8*	0.2	6.0	17.8	29.9	12.6
N. Sembilan	35.8	*27.6*	*8.2*	1.2	14.3	15.8	20.3	12.6
Pahang	37.1	*15.3*	*21.8*	14.2	3.7	15.8	16.4	12.8
Low income states								
Kedah	44.6	*19.2*	*25.4*	1.3	4.0	12.5	25.6	12.0
Kelantan	41.1	*16.4*	*24.7*	1.9	3.3	11.4	37.0	5.3
Perlis	44.9	*4.7*	*40.2*	4.1	3.9	11.4	31.8	3.9
Trengganu	36.7	*9.2*	*27.5*	15.0	2.0	12.3	27.5	6.5
Peninsular Malaysia	27.0	*14.4*	*12.6*	7.1	11.3	17.5	22.4	14.7

Source: Kok Cheong Lim (1976, p. 83).

of income and about three to four times that of the low level of income (Table 5.2). Besides that, about 60 per cent of workers in Peninsular Malaysia were found in the traditional rural sector and traditional urban sector. Less than one fifth of workers in Peninsular Malaysia were found in the modern urban sector and more than one fifth in the modern rural and government sectors (Government of Malaysia 1971).

In terms of the identification of ethnic groups with their economic activities, the majority of Malays lived in the northern states with many of them working in the traditional rural sector. Most of the non-Malays lived in the southern and western states, where the modern urban sector or the modern rural sector was the important economic activity. In fact, the income of Malays

TABLE 5.2
GDP per Capita, Sectoral Shares of GDP, and Urbanization by State, 1970

	GDP per capita	*Sectoral[1] shares of GDP (%)*			*Urban share of population[2]*
	RM	*A*	*B*	*C*	
Selangor	1,520	14	38	48	45
Penang	939	18	22	60	51
Perak	911	29	35	36	28
Negeri Sembilan	907	37	25	38	21
Pahang	855	42	23	35	19
Johor	835	40	21	39	26
Malacca	761	31	10	59	25
Kedah/Perlis	605	58	12	30	13
Trengganu	536	38	22	40	27
Kelantan	420	43	12	45	15
Peninsular Malaysia	912	29	28	43	29

Notes: 1. Sectors: A = Agriculture, forestry, fishing; B = Mining, manufacturing, construction, utilities; C = Transportation, commerce, government, other services.
2. minimum urban concentration: 10,000 persons.
Source: Salih et al. (1978, p. 89).

was generally lower than non-Malays (Table 5.3). After independence, the situation of regional disparities in Malaysia did not differ much or became worse based on some indicators. Courtenay (1972, p. 142) argued that many kinds of assistance had been given to rural development. However, with the purpose of balancing the growth and particularly maintaining the earning power of the export sector, which is the major support for the economy, the government had to encourage commercial and industrial development. In turn, the rapid growth of the commercial and industrial development brought rising imbalance of GDP per capita between the Malays and the rest as illustrated in Table 5.3. This was due to the fact that the Malays resided mostly in the less-developed states of Terengganu, Kelantan, Perlis, and Kedah while the Chinese and Indians were mostly in the more-developed states. Growth in the developed states occurred not only because of government policies but also because of the pattern of development itself.

The distributions of mean monthly household income between ethnic groups, from 1957 to 1970, showed that the gaps between Malays and non-

TABLE 5.3
State by GDP per Capita and Distribution of Population by Ethnicity, 1965 (%)

State	*GDP per capita (RM)*	*Population by Ethnicity (%)*		
		Malays	*Chinese*	*Indians*
Four Northern States				
Terengganu	459	80	13	7
Kelantan	449	92	6	2
Perlis	369	91	6	3
Kedah	536	76	18	6
	518	68	20	12
Three Southern States				
Pahang	762	51	39	10
Johor	985	55	34	11
Melaka	729	50	40	10
	638	50	40	10
Four Western States				
N. Sembilan	1,085	35	47	18
Perak	901	42	40	18
Selangor	891	40	43	17
Penang	1,493	30	47	23
	870	29	57	14
Peninsular Malaysia				
	850	50	36	14

Source: Lim (1973, p. 139).

Malays were worsening. The Gini coefficient ratio slightly increased from 0.412 in 1957 to 0.502 in 1970. The Chinese-Malay disparity ratio increased from 2.16 to 2.25 in the same period (Table 5.4). Besides that, the distribution of mean monthly household income between urban and rural areas from 1957 to 1970 also showed increases in ratio to mean monthly urban-rural income from 1.84 in 1957 to 2.14 in 1970 (Table 5.5). In terms of the poverty rate in 1970, it was alarming in the rural areas where the majority were Malays.

The levels of regional income have strong linkages with the establishment of the manufacturing sector. Subsequently, the industrial imbalance has an important relation to the imbalance of household monthly income and the regions' GDP levels. Most of the industrial areas were located in the west coast of Peninsular Malaysia.

TABLE 5.4
Distribution of Mean Monthly Household Income and Poverty between Ethnic Groups, 1957–1970 (RM)

	Mean Monthly Household Income				*Poverty*
	1957–58	*1967–68*	*1970*	*(Per cent increase) 57–70*	*(Per cent) 1970*
Malays	139	163	177	27.34	65.0[a]
Chinese	300	349	399	33.00	26.0
Indians	237	260	310	30.19	39.0
Others					44.8
Total	215	240	267	24.18	
Gini ratio	0.412	0.444	0.502	21.85	
Disparity ratio:					
Chinese/Malays	2.16	2.14	2.25	4.17	
Indians/Malays	1.71	1.60	1.75	2.34	
Chinese/Indians	1.27	1.34	1.29	1.57	

Sources: Snodgrass (1980, pp. 71, 76, 79, and 82); Government of Malaysia (1991*b*, p. 46).

TABLE 5.5
Distribution of Mean Monthly Household Income between Urban and Rural Areas, 1957–1970 (RM)

	Mean Monthly Household Income				*Poverty*
	1957–58	*1967–68*	*1970*	*Per cent increase 57–70*	*Per cent 1970*
Urban	319	360	432	35.42	21.3
Rural	173	185	202	16.76	58.7
Peninsular Malaysia					49.3
Ratio of means	1.84	1.95	2.14	16.30	

Sources: Snodgrass (1980, pp. 71, 76, 79, and 82); Government of Malaysia (1991*b*, p. 46).

Although empirical studies on growth and regional disparities have shown (Williamson 1965 and Mera 1975) that there exists a close inverse connection (inverted U-shaped relationship) between unbalanced regional development and the stage of development (time), it may be different in Malaysia's case. Experience in trends of growth and income inequality showed that Malaysia, as well as Korea and Indonesia, departed from the general trend of inverted U-shaped relationship between economic growth and income inequality (Ishak 2000). This is because poverty alleviation in the process of structural change was the ultimate goal of the national development policy.

In Malaysia's case, eradicating poverty and economic restructuring were the main objectives of Malaysia's redistributive policies, namely the NEP that has been exercised since 1971. This was because economic development during the 1950s and 1960s concentrated mainly on accelerating the maximum growth strategy of the economy through investment in infrastructure to promote maximum development of export commodities and import substitution industries. Although this strategy did serve to strengthen the economy considerably, it resulted in the unbalanced diffusion of economic activities and contributed to a marked economic activities differential between ethnic and geographical location. It did not deal adequately with the problem of social (ethnic) and economic imbalances faced by Malaysian society (Government of Malaysia 1991*a*). This was inherited from the colonial period, which caused economics of dualism in Malaysia. This economic dualism was based on economic activity as well as ethnic and geographic linkages. Most of the Malays, who lived in low-income states, were involved in the traditional agriculture sector and were less productive, while non-Malays (most of them migrated to Malaya in the early 1900s) lived in high-income states (colonial concentration states), and were involved in the non-agriculture sector or modern agriculture sector with high productivity. Dualistic economic development that exists in almost all states in Malaysia was due to foreign domination and exposure to colonization during most of the past century. Most of the indigenous Malay population which remained in the agriculture sector, mainly in rural areas or in the less-developed regions in the east coast of Peninsular Malaysia, was largely bypassed by the new development (Reynolds 1982).

NEP objectives were to be achieved through rapid growth with equal distribution. It aimed to strike an optimum balance between the goals of economic growth, to ultimately eliminate the social and economic inequalities and imbalances in the country, and promote and strengthen national integration by reducing the wide disparities in economic development between states and between the urban and rural areas in the country. Manufacturing was seen as the engine of growth to spearhead the restructuring

of economic activity and society (Rajah and Ishak 2001). The goals of the regional development policy in Malaysia can be defined as decreasing the socio-economic gap between regions and increasing the quality of life in the less-developed states/areas, goals which parallel the national development goal of "growth with equal distribution".

Among the four regional development strategies, the industrial dispersal strategy was seen as the most important tool to overcome the problem of unequal development between regions in Peninsular Malaysia (as the engine of growth to spearhead the restructuring of economic activity and society). The strategy was introduced after 1956 under the First Malaya Plan (1956–1960). This strategy was accompanied by the rural strategy on urbanization and creation of new growth centres to enhance industrial development and urbanization, scatter new development and growth, especially to the less-developed states, increase economic opportunities as well as monthly income, decrease poverty and unemployment in the less-developed areas by diversifying the economic base of the less-developed states, and generate higher economic growth. This included the establishment of industrial areas as growth centres, which were located near major towns. Furthermore, under Investment Incentive Acts, a number of instruments have been used to achieve this strategy, which included tax holidays, investment allowances, and the provision of industrial estates and free trade zones in a particular development location to make it more attractive to private investors. This strategy was also used as a tool to decrease out-migration from rural areas (and less-developed states) to the established congested areas (more-developed states). Regional development plans were integrated into the national plan in the Outline Perspective Plan and every five-year development plan (Table 5.6).

Since 1971, under the NEP aimed at eradicating poverty and restructuring society, the Malaysian Government has tried to promote a balance in economic activities in order to overcome marked economic differences between geographical locations. Development planning has changed from "building upon the best" (under British colonial times) to "accelerating maximum growth" (1950s and 1960s), and finally to "growth with equal distribution" (1971 until now).

The NEP was the essence of Malaysia's First Outline Perspective Plan (1971–1990) which included four five-year plans; i.e., Second Malaysia Plan (1971–1975) up to Fifth Malaysia Plan (1986–1990). The Second Outline Perspective Plan (1991–2000), which was implemented within the framework of the New Development Policy (NDP), consisted of two five-year plans; i.e., the Sixth and Seventh Malaysia Plans. Currently, Malaysia is undergoing its Third Outline Perspective Plan (2001–2010), which is implemented within

TABLE 5.6
National Planning, 1950–2010

Long-term Development Plan/ National Policy	*Years*	*Five year Development Plan*
	1950–1955	Draft Development Plan, Malaya
	1956–1960	First Malaya Plan
	1961–1965	Second Malaya Plan
	1966–1970	First Malaysia Plan
First Outline Perspective Plan New Economic Policy (1971–1990)	1971–1976	Second Malaysia Plan
	1977–1980	Third Malaysia Plan
	1981–1985	Fourth Malaysia Plan
	1986–1990	Fifth Malaysia Plan
Second Outline Perspective Plan National Development Policy (1991–2000)	1991–1995	Sixth Malaysia Plan
	1996–2000	Seventh Malaysia Plan
Third Outline Perspective Plan National Vision Policy (2001–2010)	2001–2005	Eighth Malaysia Plan
	2006–2010	Ninth Malaysia Plan

Sources: Asan (2004; 2006).

the National Vision Policy (NVP), and consists of the Eighth and Ninth Malaysia Plans.

Even though the NEP ended in 1990 the country's development objective of achieving "growth with equal distribution" is still being given priority in the NDP and NVP due to the fact that the objective has not yet being achieved, as echoed by the then Prime Minister Abdullah Badawi when delivering the Ninth Malaysia Plan, "the wealth and income gaps still exist especially among ethnic groups, and between urban and rural areas".

REGIONAL DEVELOPMENT IN THE MALAYSIAN CONTEXT

Since 1981 the states in Malaysia have been aggregated into six regions (Government of Malaysia 1981). Each region consists of a contiguous landmass, which is in a more or less uniform stage of development and may encompass an entire state or a group of states. In general, these regions

share similarities in resources and in terms of economic activities and have been dominated by a single metropolitan area (growth centre). Peninsular Malaysia consists of four regions while East Malaysia consists of two regions (Figure 5.1).

FIGURE 5.1
Location of Regions in Peninsular Malaysia

Source: Asan (2006).

Regions in Peninsular Malaysia (West Malaysia):

1. *Northern region*: consists of four states — Perlis, Kedah, Penang, and Perak, with Georgetown as the growth centre.
2. *Central region*: consists of four states — Selangor, Federal Territory of Kuala Lumpur, Negeri Sembilan, and Melaka, with Kuala Lumpur as the growth centre.
3. *Eastern region*: consists of three states — Kelantan, Terengganu, and Pahang, with Kuantan as the growth centre.
4. *Southern region*: consists of one state, Johor, with Johor Bahru as the growth centre.

Regions in East Malaysia:

1. *Sabah region*: consists of Sabah (including Federal Territory of Labuan), with Kota Kinabalu as the growth centre.
2. *Sarawak region*: consists of Sarawak, with Kuching as the growth centre.

Starting in 2001 the composite development index has been used and the states in Malaysia have been divided into two categories based on the level of development (Government of Malaysia 2001*b*, p. 116). The composite development index comprises ten indicators: GDP per capita, unemployment rate, urbanization rate, registration of cars and motorcycles per 1,000 of population, poverty rate, population provided with piped water, population provided with electricity, infant mortality rate, and number of doctors per 10,000 of population. Based on these indicators, states in Malaysia have been divided as follows (Figure 5.2):

1. *More developed states*: Johor, Melaka, Negeri Sembilan, Perak, Penang, Selangor, and Federal Territory of Kuala Lumpur.
2. *Less developed states*: Kedah, Kelantan, Pahang, Perlis, Sabah, Sarawak, and Terengganu.

URBANIZATION, INCOME REDISTRIBUTION, AND POVERTY REDUCTION

The manufacturing industry (secondary sector) is often thought of as the engine of economic growth for a country. However, this sector is often concentrated in the urban areas which leads to a large migration of people from the rural areas to the major cities such as Kuala Lumpur, Petaling

FIGURE 5.2
Location of States by Levels of Development in Peninsular Malaysia

Source: Asan (2006).

Jaya, Penang, and Johor Bahru. In Malaysia the urbanization rate is based not only on the rural-to-urban migration but also on the natural increase in population in that particular area. The urbanization rate[2] in Peninsular Malaysia increased rapidly from 27 per cent in 1970 to 62 per cent in 2000, and it was more concentrated in the developed states. Although the

Primacy Index (PI)[3] fell from 0.38 in 1991 to 0.29, which showed that the concentration of population in the primary city was decreasing, three major towns in the less-developed states (Kota Bharu, Kelantan; Kuala Terengganu, Terengganu; and Kuantan, Pahang) were taken over by metropolitan towns in Selangor (Subang Jaya, Ampang Jaya, and Shah Alam, Table 5.7). Kuala Lumpur remained the primary city with a population size of approximately three times that of the second-largest urban centre, Ipoh, in 1991 to two times that of the second-largest urban centre, Johor Bahru, in 2000. In 2000, metropolitan towns located in less-developed states in Peninsular Malaysia were Kuantan, Kuala Terengganu, and Kota Bharu, which were four to five times smaller than Kuala Lumpur.

TABLE 5.7
The Primacy Index for Major Metropolitan Towns, Malaysia, 1991 and 2000

	1991			*2000*		
	Metropolitan Towns	*Population (thousands)*	*Ratio KL to the others*	*Metropolitan Towns*	*Population (thousands)*	*Ratio KL to the others*
1	Kuala Lumpur	1,145.3	1.0	Kuala Lumpur	1,305.7	1.0
2	Ipoh	468.8	2.4	Johor Bahru	642.9	2.0
3	Johor Bahru	441.7	2.6	Klang	626.6	2.1
4	Klang	368.4	3.1	Ipoh	536.8	2.4
5	Petaling Jaya	351.0	3.3	Subang Jaya	437.1	3.0
6	Kuching	277.9	4.1	Petaling Jaya	432.6	3.0
7	Kota Bharu	234.6	4.9	Kuching	422.2	3.1
8	Kuala Terengganu	228.1	5.0	Ampang Jaya	357.9	3.6
9	Georgetown	219.6	5.2	Shah Alam	314.4	4.2
10	Kuantan	202.4	5.7	Kota Kinabalu	306.9	4.3
11	Seremban	193.2	5.9	Seremban	290.7	4.5
Primacy Index			0.38			0.29

Source: Siti (2007, p. 23).

However, in terms of distribution of the urbanization ratio in Peninsular Malaysia from 1970 to 2000, it responded well to the government policy. The ratio of the urbanization rate of Kuala Lumpur to the other areas decreased (Table 5.8). For example, the ratio of the urbanization rate of Kuala Lumpur to Kedah has decreased from 8 in 1970 to only 3 in 1995. In general, in the year 2000, the ratio of the urbanization rate of Kuala Lumpur to other more-developed states was around 1 to 2, while for the less-developed states, it was around 2 to 3. In 1980, the ratio of the urbanization rate of Kuala Lumpur to other more-developed states was around 2 to 3, while for the less-developed states, it was around 2 to 11. The urbanization rate in the more-developed states ranged from 25 per cent to 100 per cent in 1970, and increased to 55 per cent to 100 per cent in 2000. The urbanization rate in the less-developed states ranged from 0 per cent to 27 per cent in 1970, and increased to 34 per cent to 50 per cent in 2000. It showed that the distribution of the urbanization rate in Peninsular Malaysia has become more equal.

The ethnic composition of the urban population changed with increased involvement of Malays in the industrial and commercial sectors of the economy in line with the NEP (Table 5.9). In 1970 only about 14.8 per cent of Malays lived in urban areas. However, by 2000 this proportion rose to 50.6 per cent.

TABLE 5.8
Urbanization Rate by State, 1970–2000

		Urbanization rate					
		70	*80*	*85*	*90*	*95*	*00*
More-developed states	Selangor	45.0	34.2	34.5	55.3	80.8	88.3
	Penang	50.7	44.7	49.3	60.4	77.0	79.5
	Perak	27.5	32.2	32.3	33.6	56.2	59.5
	Johor	26.3	35.2	35.3	43.7	54.4	63.9
	Melaka	25.1	23.4	23.3	23.3	49.5	67.3
	Negeri Sembilan	21.5	32.6	32.6	42.1	47.3	55.0
	Kuala Lumpur	100	100	100	100	100	100
Less-developed states	Terengganu	27.0	42.8	42.8	51.1	46.6	49.4
	Kedah	12.7	13.9	14.4	16.0	35.1	38.7
	Kelantan	15.1	27.7	27.7	32.1	33.5	33.5
	Pahang	19.0	26.2	26.2	24.6	35.0	42.1
	Perlis[1]	—	8.7	8.8	11.2	29.6	33.8

Note: 1. Perlis, urbanization rate 1970 = 0
Source: Asan (2004).

TABLE 5.9
Distribution of Population by Ethnic Groups, 1999 and 2000

1991	*Total*		*Urban*	
	Number (thousands)	*Per cent*	*Number (thousands)*	*Per cent*
Bumiputra	10,646.4	60.6	4,410.2	39.7
Chinese	4,945.0	28.1	3,817.5	76.0
Indian	1,394.0	7.9	897.2	63.8

2000	Number (thousands)	Per cent	Number (thousands)	Per cent
Bumiputra	14,248.2	65.1	7,258.7	50.6
Chinese	5,691.9	26.0	4,848.1	85.9
Indian	1,680.1	7.7	1,356.1	80.0

Sources: Government of Malaysia (2005, p. 23).

In terms of the rate of growth of the urban population, the highest was Malays/bumiputra followed by Chinese and Indians. However, the Chinese still accounted for more than three quarters of the urban population.

Although generally the urbanization rate has increased in less-developed states (due to the increase of new economic activities), high out-migration still occurs from the less-developed states to the more-developed states. These migrants consist of both low- and high-skilled workers and constitute Malays/bumiputra and non-Malays/bumiputra. This phenomenon occurs mainly because of the large disparity of wages between the less-developed and more-developed states. For example in 1984 the average monthly household income in Kuala Lumpur was 3 times higher than that in Kelantan (Table 5.10). Although in 2007 the ratio of Kuala Lumpur incomes to those in the less-developed states has decreased, it was still at least 2 times higher than those in the less-developed states. The ratio in the less-developed states ranged from 2 to 3 in 2007.

Undeniably, the combined effects of the deliberate poverty eradication policies and the rapid growth of the economy led to a decline in the incidence of poverty in all states in Peninsular Malaysia. Incidence of poverty in Malaysia has decreased from 52.4 per cent in 1970 to only 3.6 per cent in 2007 (Table 5.11). In other words, incidence of poverty has decreased 93 per cent since the implementation of the NEP, which was attained through rapid socio-economic development with significant participation of the poor.

TABLE 5.10
Mean Monthly Household Income by State, 1984 and 2007

	State	*1984*	*Ratio*	*2007*	*Ratio*
Less-developed states	Kelantan	500	3.1	2,143	2.5
	Kedah	552	2.8	2,408	2.2
	Terengganu	604	2.5	2,463	2.2
	Perlis	553	2.8	2,541	2.1
	Pahang	767	2.0	2,995	1.8
More-developed states	Perak	706	2.2	2,543	2.1
	Melaka	831	1.8	3,421	1.6
	Negeri Sembilan	831	1.8	3,336	1.6
	Johor	851	1.8	3,457	1.5
	Penang	946	1.6	4,004	1.3
	Selangor	1,271	1.2	5,580	1.0
	Kuala Lumpur	1,535	1.0	5,322	1.0

Note: A ratio of mean monthly household income of Kuala Lumpur to other states.
Sources: Hashim Shireen-Mardziah (1998, p. 73); Economic Planning Unit (2007).

TABLE 5.11
Poverty Rate (%), Malaysia, 1970–2007

	1970	*1985*	*1990*	*1995*	*1997*	*1999*	*2002*	*2004*	*2007*
Total	52.4	20.7	16.5	8.9	6.1	7.5	5.1	5.7	3.6
Urban	22.3	8.5	7.1	3.7	2.1	3.4	2	2.5	1.9
Rural	60	27.3	21.1	15.3	10.9	12.4	11.4	11.9	7.1

Sources: Chamhuri (2010); Economic Planning Unit (2007).

The overall poverty rate in Malaysia has decreased from 52.4 per cent in 1970 to 16.5 per cent in 1990, and reduced further to 6.1 per cent in 1997. The 1999 economic slowdown saw the rate increased to 7.5 per cent but later decreased to 5.7 (Government of Malaysia 2001). In 2004 the poverty rate was at 5.7 per cent due to the application of a new methodology in redefining Malaysia's poverty income line (Government of Malaysia 2006). The number of poor households also dropped from approximately 1 million in 1970 to 311,300 in 2004 (Chamhuri 2010).

Generally poverty is defined as the inability of households to obtain the necessities of life or basic needs measured in terms of income or

consumption. In Malaysia, poverty is measured using poverty line income (PLI) which reflects the minimum level of income or consumption on those basic goods such as food, clothing, housing, and basic services such as education, medical care, transport, recreation, and cultural services. A household is considered poor if its income or consumption is below the official PLI. Table 5.12 shows the basic consumption components for Peninsular Malaysia, Sabah, and Sarawak. The PLI is different for each of these regions. The major components in the PLI are food, rent, fuel and power, transport, and communications.

In 2005 the PLI was revised to incorporate PLIs for food and non-food items. The PLI is defined differently for each household depending on the size of the household, demographic composition, and location (state and stratum). A household is considered poor if it is unable to fulfil the basic requirements of its members, i.e., if its income is less than its PLI. Absolute poverty exists when the household's income is less than PLI for food, which is a new measurement used currently, and its value is usually higher than the old measurement that used half of PLI (Government of Malaysia 2006).

TABLE 5.12
Components of PLI (%), 1997–2002

Consumption Components	*Peninsular Malaysia*		*Sabah*		*Sarawak*	
	1997	*2002*	*1997*	*2002*	*1997*	*2002*
1. Food	62.1	65.5	60.0	53.8	57.8	61.2
2. Clothing and Footwear	7.7	5.6	6.0	4.7	6.6	5.1
3. Others	25.5	24.1	39.2	36.8	30.8	28.9
a. Rent, Fuel and Power	13.2	12.7	23.1	20.7	8.9	7.9
b. Furniture and Household Equipment	2.3	2.0	2.9	2.6	3.1	2.8
c. Medical Care and Health Expenditure	1.2	1.3	1.1	1.1	6.1	6.0
d. Transport and Communications	6.8	6.3	9.0	9.2	8.9	8.7
e. Education, Recreation, and Cultural Services	2.1	1.9	3.2	3.1	3.9	3.6
4. Safety Margins (5%)	4.8	4.8	4.8	4.8	4.8	4.8
Total	100.0		100.0		100.0	

Source: Chamhuri (2010).

Prior to the NEP much of the focus of development policies and programmes was centred on growth. Under the NEP the strategy of poverty eradication called for a pattern of development which provided opportunities for the poor to participate effectively in the growth process and share the benefits of development. Major poverty eradication strategies were through land development and in situ agriculture programmes, apart from the absorption of the rapidly growing rural labour force into higher income jobs in the industrial and services sectors.

The improvements made in respect to poverty eradication in Peninsular Malaysia are shown in Table 5.13. Despite the substantial progress made, poverty remained a problem in the less-developed states, especially in Kedah, Perlis (in the Northern region), Terengganu, and Kelantan (in the Eastern region).[4] In these states the poverty rates were still relatively high, ranging from 7.2 to 3.1 per cent in 2000. In less-developed states, besides the high incidence of poverty that existed at the beginning of the NEP, the agricultural sector remained important in these states. In most developing countries, including Malaysia, the poverty rate was high in the agricultural sector, especially among the small holders (Williams 1991; Malaysia 2001*c*).

Although the poverty rate was high in the agricultural sector, it was different in the state of Pahang. The opening of new land for resettlement was one of the programmes that contributed to the reduction of poverty. About

TABLE 5.13
Incidences of Poverty by State

	State	*1970*	*1990*	*2007*
More-developed states	Kuala Lumpur	45.0	3.8	1.5
	Johor	29.2	10.1	1.5
	Selangor	43.7	7.8	0.7
	Penang	44.9	8.9	1.4
	Melaka	44.8	12.4	1.8
	N. Sembilan	48.6	9.5	1.3
	Perak		19.3	3.4
Less-developed states	Pahang	43.2	10.3	1.7
	Perlis	64.5[1]	17.2	7.0
	Kedah		30.0	3.1
	Terengganu	68.9	31.2	6.5
	Kelantan	76.1	29.9	7.2

Note: 1. Kedah including Perlis for the 1970 data.
Sources: Asan (2004); Economic Planning Unit (2007).

30 per cent of the rural households in this state were involved in the Federal Land Development Authority (FELDA) schemes. Income improvements among settlers in land development schemes were more substantial. The average monthly income of settlers on FELDA schemes ranged from RM490 to RM810 in 1979 compared with incomes of only about RM80 to RM120 from their previous occupations (Government of Malaysia 1981).

The encouragement by the government towards dispersal of industries in the less-developed states in which the majority of the population was the Malay ethnic group enabled the poor rural and urban households to gain employment in manufacturing activities, thereby raising their levels of income. In 1980 only about 17.1 per cent of the total investment approved in manufacturing projects was planned to be located in the relatively less-developed states where the incidence of poverty was high. By 1997 the proportion increased to 44.7 per cent of total investment approved in manufacturing projects.

Mean monthly gross household income by the Malay ethnic group increased tremendously from only RM172 in 1970 to RM3,156 in 2007 (Table 5.14). The percentage annual growth rate of the mean monthly gross household income of the Malay ethnic group was highest compared to other ethnic groups during the period. However, the Chinese mean income was still above the national average. As the mean monthly gross household income increased, the poverty rate for the Malay ethnic group decreased from 64.8 per cent in 1970 to 3.3 per cent in 2007 (Table 5.15). However, poverty among Malays was still relatively high compared with other ethnic groups in the rural and urban areas.

The poverty rate tends to have a positive relationship with the percentage of the Malay ethnic population, number of persons employed in the primary

TABLE 5.14
Mean Monthly Gross Household Income by Ethnic Group
(in Current Prices, RM)

	1970	*1990*	*2007*
Malays	172	940	3,156
Chinese	394	1,631	4,853
Indians	304	1,209	3,799
MALAYSIA	264	1,167	3,620
Urban	428	1,617	4,295
Rural	200	951	2,239

Sources: Asan (2004); Economic Planning Unit (2007).

TABLE 5.15
Poverty by Ethnic Group

	1970	*1990*	*2007*		
	Total	*Total*	*Total*	*Urban*	*Rural*
Malay	64.8	20.8	5.3	3.0	8.2
Chinese	26.0	5.7	0.6	0.5	1.1
Indians	39.2	8.0	2.6	2.4	3.9
Total	49.3	15.0	3.6	1.9	7.1

Sources: Chamhuri and Surtahman (1999, p. 374); Economic Planning Unit (2007).

sector, and percentage of labour force with no primary level of education. In terms of the agricultural sector itself, the poverty rate tends to have a positive relationship with hectares of paddy and rubber plantation areas but not with hectares of oil palm. This was also another reason why the poverty rate in Pahang was less compared to other less-developed states. Usually all FELDA schemes in Pahang were planted with oil palm. Besides that, the poverty rate also tends to have a positive relationship with distance from Kuala Lumpur and distance from regional growth centres (Asan 2004).

The higher education level and experienced labour force are another two factors that make investors more interested in the developed regions than less-developed areas (Meerman 1979). Moreover, there is an inverse relationship between the education level and the poverty rate. This means that when the education level is increasing, the poverty rate will decrease (Mohd Yusuf 1990). Also, an educated and experienced worker will migrate to the developed regions and the inexperienced ones will remain in the less-developed states (Pryor 1979).

INCENTIVES AND MANUFACTURING DISPERSAL

In order to promote industrial activities in the less-developed states (or districts), the government introduced the concept of a "development area" under the Investment Incentive Act, 1968. Industries that were located in these areas would be granted additional incentives.[5] The "development areas" covered the entire states of Perlis, Terengganu, Melaka, Sabah, Sarawak, and the relatively less-developed districts of Kedah (excluding Kuala Muda district), Pahang (excluding Kuantan district), and southeast of Johor (Figure 5.3). It also included two industrial estates: Kemunting Industrial Estate (in the state of Perak) and Senawang Industrial Estate (in the state of Negeri Sembilan),

TABLE 5.16
Correlation between Poverty and Some Demographic, Economic, and Location Variables

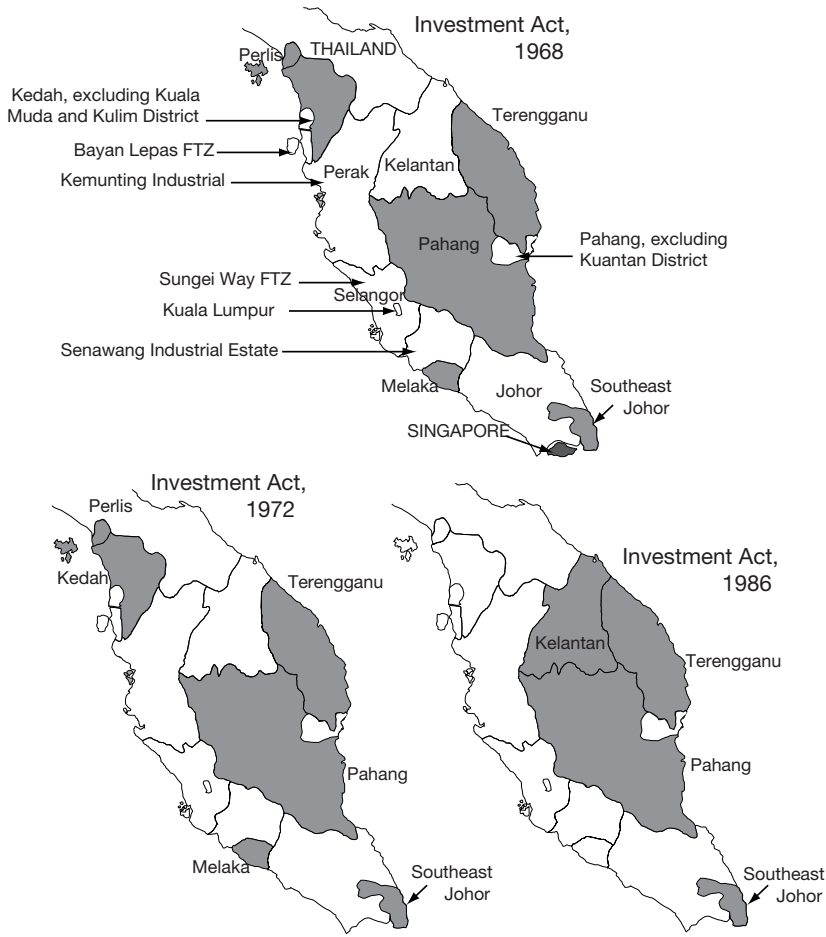
	Positive Correlation	*Negative Correlation*
Percentage of Malay population	0.33*	
Percentage of Chinese population		–0.28*
Percentage of Indian population		–0.30
Percentage of Other population		–0.43*
Number of persons employed in primary sector	0.31*	
Number of persons employed in secondary sector		–0.46*
Number of persons employed in tertiary sector		–0.42*
Percentage Labour Force by Level of Education, No formal education	0.86**	
Percentage Labour Force by Level of Education, Primary	0.47**	
Percentage Labour Force by Level of Education, Secondary		–0.68**
Percentage Labour Force by Level of Education, Tertiary		–0.53**
Job vacancies		–0.33**
Agriculture – paddy (hectare)	0.36**	
Agriculture – palm oil (hectare)		–0.40**
Agriculture – rubber (hectare)	0.24**	
Distance from Kuala Lumpur	0.40**	
Distance from regional growth centres	0.46**	

Notes: **Correlation is significant at the 0.01 level (2-tailed); *Correlation is significant at the 0.05 level (2-tailed).
Sources: Asan (2004; 2006).

and two Free Trade Zone (FTZ) industrial areas: Bayan Lepas FTZ (in the state of Penang) and Sungei Way FTZ (in the state of Selangor). These two industrial areas were the pioneer industrial areas and were isolated from the concentrated industrial areas in the state of Selangor and Penang, while the FTZs were the pioneer FTZs in Malaysia.

After the implementation of the NEP, the government introduced the "Location Incentive Scheme" (under Investment Incentive Act, 1972). More incentives were given to the local and foreign investors to

FIGURE 5.3
Investment Incentives Location Act 1968, 1972, and 1986



Source: Asan (2006).

locate their activities in the less-developed states (or districts),[6] mainly to redistribute the industrial activities from more concentrated areas in the more developed states. Compared with the development area under the Investment Incentive Act, 1968, the Location Incentive Act, 1972 only covered the entire states of Perlis, Terengganu, Melaka, Sabah, Sarawak, and the relatively less-developed districts of Kedah (excluding Kuala Muda

district), Pahang (excluding Kuantan district), and southeast of Johor. It did not include Kemunting Industrial Estate, Senawang Industrial Estate, Bayan Lepas FTZ, or Sungei Way FTZ because it referred only to the less-developed states (or districts).

Further incentives were given under the Promotion of Investments Act 1986, which was introduced as a replacement for the Investment Incentive Act, 1972. Although industrial development focused more on the West-Coast Corridor, additional incentives were given to the industries located in the East-Coast Corridor of Peninsular Malaysia. It covered Kelantan, Terengganu, Pahang, and the district of Mersing in the southeast of Johor. Compared with the Location Incentive Scheme, additional incentives under the Promotion of Investments Act 1986 did not cover the states of Melaka, Kedah, or Perlis (located on the west coast of Peninsular Malaysia) because the additional incentives were only given to the industries located in the East-Coast Corridor of Peninsular Malaysia, mainly to give it more of a comparative advantage.[7]

The Investment Incentive Act was replaced for two reasons. Firstly, to make investment in Malaysia more attractive and to have a competitive advantage over other countries in the ASEAN region. This is because other countries also have their investment incentives and Malaysia must compete to attract FDI, especially from multinational companies. Secondly, regarding the additional incentives given to the selective states or districts, the number of states that received the incentive was decreased from six states under Investment Act 1972 to only three states under Investment Act 1986. Kedah, Perlis, and Melaka — that were given additional incentives under Investment Act 1972 — no longer received additional incentives under Investment Act 1986. Manufacturing activities in these states increased rapidly and focus had to be given only to the states located in the East-Coast Corridor (Kelantan, Terengganu, and Pahang) where the manufacturing activities were relatively less. Other than incentives under the Investment Incentive Act, the State Economic Development Council (SEDC) also provided some incentives to promote investors, especially FDI, to set up factories in those particular states since 1971.

Besides the huge incentives in manufacturing industries, especially in the less-developed states, the government also took further steps to promote manufacturing industries by developing industrial estates. The strategy seeks to encourage new manufacturing industries to move to the less-developed parts of the country, especially in the east coast states, from the congested areas in Selangor (Klang Valley) and other major urban centres on the west coast. Numbers of existing industrial estates increased rapidly in the states of

Kedah, Perak, Terengganu, Selangor, and Johor. In the less-developed states, the number of existing industrial estates increased rapidly from none in 1970 to 105 in 2002, while in more-developed states the number increased from 8 in 1970 to 188 in 2002 (Table 5.17). Although the number of existing industrial estates in the less-developed states increased, the size of the industrial estates was rather small. This is because most of the industries located in the less-developed states were small and medium industries (SMI) and labour intensive. In 1990 only 3 per cent of industrial estates in less-developed states were larger than 200 hectares, while 11 per cent of industrial estates in the more-developed states were greater than 200 hectares.

Although the manufacturing sector in Peninsular Malaysia as a whole experienced rapid average annual output growth rate, its distribution was

TABLE 5.17
Number of Existing Industrial Estates, 1970, 1990, and 2002

	1970	*1990*	*2002*	
			Number	*Expansion 1990–2002*
– Perlis*	0	2	7	5
– Kedah*	0	15	28	13
– Penang	3	9	18	9
– Perak	1	19	34	15
Northern Region	4	45	87	42
– Pahang*	0	11	34	23
– Kelantan*	0	6	15	9
– Terengganu*	0	12	21	9
Eastern Region	0	29	70	41
– Selangor	2	25	37	12
– N. Sembilan	1	8	18	10
– Melaka	0	7	27	20
– K. Lumpur	0	4	19	15
Central Region	3	44	101	57
Johor/Southern Region	1	20	31	11
*Less Developed States**	0	46	105	59
More Developed States	8	92	188	96
Peninsular Malaysia	8	138	289	151

Sources: Asan (2004; 2006).

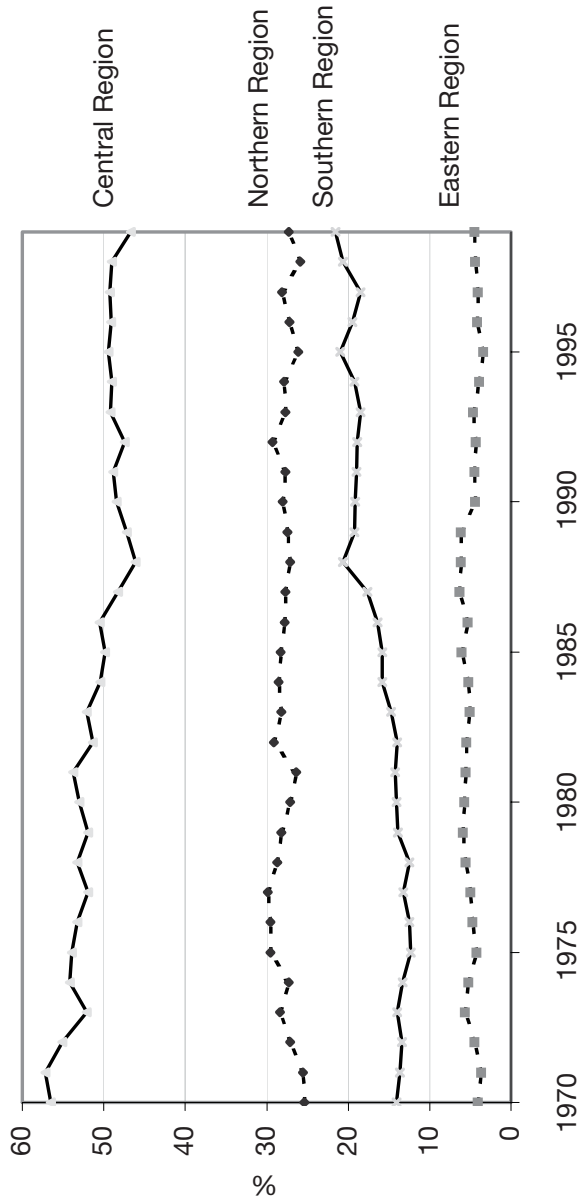
still more towards developed states. In fact, although the federal and state governments have made serious efforts to increase manufacturing activities in less-developed states by introducing several incentives, the distribution of manufacturing activities in Peninsular Malaysia had not changed much by the end of the NEP (1970–90). Figures 5.4 and 5.5 show the percentage contribution of output and labour by region for the period 1970 until 1999. These trends show that decreasing output and labour contributed by the central region were not overtaken by the northern and eastern regions but by the southern region. It contradicted the government policy to increase output and labour contributed by the northern and eastern regions.

Although the government redistribution policy has increased manufacturing output and labour in the northern region, a greater percentage increase came from the state of Penang but not from the states of Kedah or Perlis (less-developed states). In the eastern region (all states in the eastern region were categorized as less-developed states) the output contribution was relatively small, at only 0.3 per cent, while labour contribution did not increase but decreased about 1.4 per cent. Government policy was also intended to decrease output and labour contributed by the central and southern regions. However, the policy only succeeded in the central region. In the southern region, output and labour contribution continued to increase.

States that recorded a huge decrease in their output and labour contributions to the Malaysian total were Selangor and Perak, while states that recorded a big increase in output and labour contributions to the Malaysian total were Penang (7.4 per cent) and Johor (5.1 per cent). This situation showed that several incentives under the federal and state governments were not successful in their goal to increase manufacturing activities in the less-developed states. Penang and Johor were not placed under any Development Area, Location Incentive Scheme, the East-Coast Corridor, or any other incentives under SEDC, but the manufacturing output and labour contributions increased and were still relatively high. Although the district of Mersing (in southeast Johor) was placed under the Development Area status, the Location Incentive Scheme, and is currently under the East-Coast Corridor, Mersing industrial area contributed less than 2 per cent of the total manufacturing output and labour.[8]

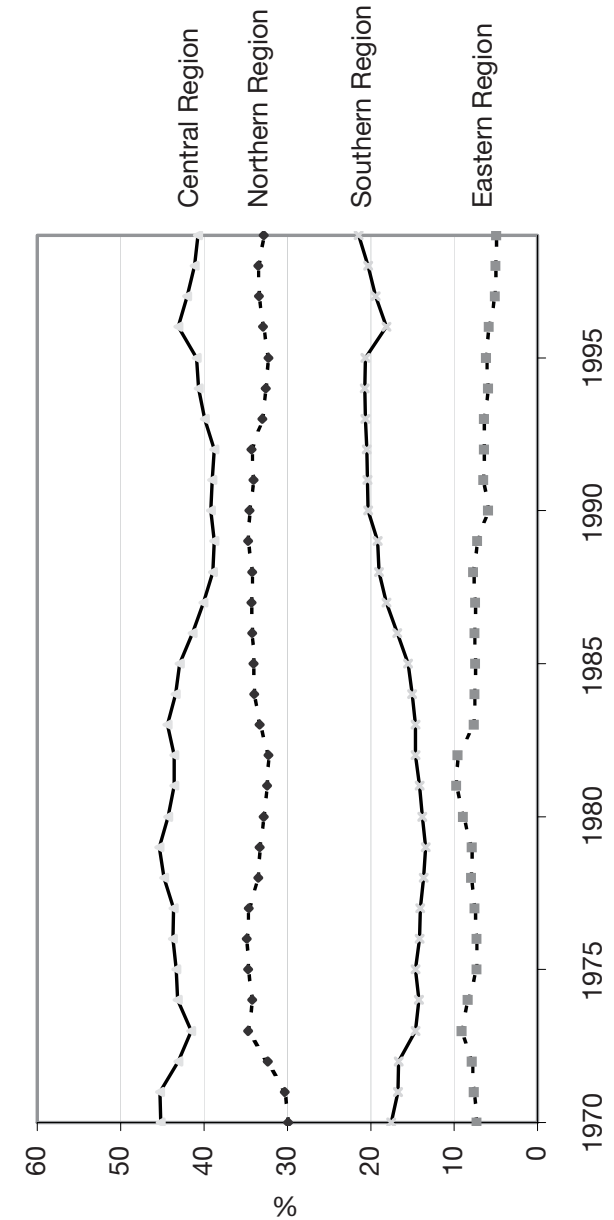
An investment incentive plays an important role in increasing manufacturing activities in Malaysia. Investment incentives in Malaysia started with the Investment Incentive Act, 1968 which was replaced by the Investment Incentive Act, 1972. Further incentives were given under the promotion of Investments Incentive Act, 1986,[9] which was introduced as a replacement to the Investment Incentive Act, 1972. The most apparent effects from the

FIGURE 5.4
Percentage Contribution of Output



Sources: Asan (2004) and Hasnah and Asan (2008).

FIGURE 5.5
Percentage Contribution of Output



Sources: Asan (2004) and Hasnah and Asan (2008).

government industrial incentives are in terms of the Investment Incentive Act, 1986. Before the 1986 act, about 37 to 47 per cent of approved projects were the result of investment incentives given by the government (Table 5.18). This amount increased rapidly after the 1986 act. For instance, in 1990, the amount increased to about 58 per cent. However, it decreased in 1997 due to the economic downturn. Most of the industries that received this incentive were the export-oriented industries located in the more-developed states, especially in Selangor, Penang, and Johor. Location incentives were less effective; projects approved under this incentive were small compared to other incentives — they account for less than 3 per cent of the approved manufacturing projects with incentives.

The unbalanced distribution of industrial concentration between states was the other main factor that created unbalanced growth between states in Peninsular Malaysia. There are two groups of industries distributed in the regions. The first group encompasses modern technology industries, especially for exported products, which can be seen in the well-developed regions, and the second is the small industries for domestic goods in the less-developed

TABLE 5.18
Approval of Manufacturing under Investment Incentive Acts of 1972 and 1986

Investment Incentive Act	*Investment Incentive Act, 1972*			*Investment Incentive Act, 1986*		
	1976	*1980*	*1985*	*1990*	*1997*	*2000*
With incentive:	202 *(47.5)*[1]	184 *(40.0)*	229 *(36.6)*	524 *(57.8)*	213 *(28.1)*	205 *(25.5)*
– Pioneer status	105	104	78	440	154	153
– Investment Tax Allowance	76	73	143	84	59	52
– Location incentive[2]	7	2	8	—	—	—
Without incentive	223	276	396	382	546	600
Total	425	460	625	906	759	805

Notes: 1. Figures in parentheses show the percentage.
2. Number of manufacturing approved with location incentive was not recorded separately because it was incorporated under Pioneer status and Investment Tax Allowance deduction (Act, 1986).

Sources: Asan (2004; 2006).

regions. Inequality in this industry distribution will create a problem as it affects the population as well as the income of the regions.

Industrialization in Malaysia gradually shifted from an import-substitution industry in the 1960s to an export-oriented one in the 1970s, and later to heavy industry since the early 1980s. Exports of commodities as a main source of growth, for both the economy and the agricultural sector, were no longer important. Agricultural exports declined in share from 52.1 per cent in 1970 to only 35.8 per cent in 1980, mainly due to the slow growth in the production of rubber and the emergence of crude oil and manufactured goods as important export commodities. After 1980 (the start of the Fourth Malaysia Plan) the manufacturing sector was projected to grow at a rapid rate of 10.9 per cent per annum (Government of Malaysia 1981).

The final aim of the industrialization strategy since 1970 was to meet the NEP objectives of growth and equal distribution. This is because manufacturing was seen as the engine of growth to spearhead the restructuring of economic activity and society, besides absorbing the surplus labour from the agriculture sector (Rajah and Ishak 2001). Emphasis was given to the creation of employment, development of all scales of industries, and participation of Malays in the manufacturing sector, especially in the less-developed states. The structural change from a labour-intensive manufacturing industry to a capital intensive (heavy) manufacturing industry and optimization of the use of resource-based industries have somehow increased the relative role of manufacturing activities in the less-developed states.

Growth in the manufacturing sector since the 1980s was a result of the diversification of manufacturing towards capital-intensive industry, especially export goods, as well as maximizing the comparative advantage of Malaysia's resource endowment. Specific tax incentives were also provided to encourage the growth of export-oriented industries. In addition a substantial proportion of manufactured exports came from the FTZs.[10]

FTZs are specially designated for export-oriented industries. Currently, there are sixteen FTZs in Malaysia. Eleven of the FTZs are located in the more-developed states. The infrastructure network, which provides easy access to the services industry, was the main reason why most of the FTZs were located in the more-developed states. The FTZs were developed near to the well-established industrial estates and infrastructure network mainly to generate backward and forward linkages to other industries as well as to make it more attractive to FDI.

In general, the electronic (and machinery) industry, as Malaysia's main source of manufacturing exports, was concentrated in more-developed states in 1985 and more so in 1995. In less-developed states, this industry became

important only in the state of Kedah. Selangor, Penang, and Johor recorded a high share of total national manufacturing output in three important industries. Of the five less-developed states, Kedah, Perlis, and Terengganu have changed their economic structure rapidly, while Pahang and Kelantan did not change much. Electronic industries have become more important in Kedah, while heavy industry expanded in Terengganu and Perlis. Although Kelantan and Pahang received extra investment incentives (under Investment Incentive Act, 1986 — East-Coast Corridor) the industrialization process was slow and more concentrated on resource-based (wood and rubber) and food manufacturing industries. These industries have less potential for employment and are more focused on domestic products rather than being export-oriented.

Although the concentration of these industries is on the rise in the less-developed states, the concentration of capital, labour, value added and output remained more dominant in the developed states. As a result, value added per worker, output per worker, and average monthly wage per worker were higher in the developed states compared to the less-developed states (Figure 5.6 and Table 5.19).

REGIONAL CONVERGENCE

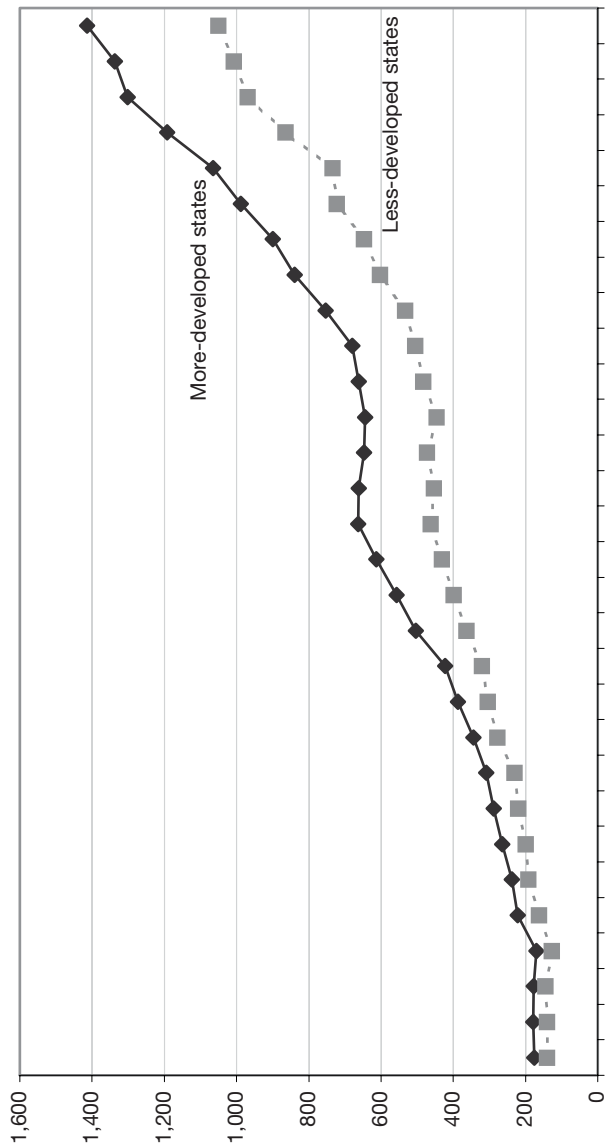
Since independence, and especially after 1970, it was hoped that the manufacturing sector would increase economic opportunities through diversification of economic activities in the less-developed states as well as

TABLE 5.19
Value Added, Output, and Capital Per Worker (RM)

Region	*Year*	*Value added per worker*	*Output per worker*	*Total Manufacturing Output ('000)*
More-Developed States	1970	7,881	25,814	3,617,357
	1980	9,584	67,420	27,964,096
	1990	29,232	118,427	79,615,778
	1999	65,942	279,246	303,631,335
Less-Developed States	1970	4,414	17,803	316,681
	1980	5,747	44,254	2,812,780
	1990	20,218	73,901	7,637,396
	1999	48,512	193,592	25,627,524

Sources: Asan (2004; 2006).

FIGURE 5.6
Average Monthly Wage Per Worker (RM) in the More-developed and Less-developed States, 1970–1999



Source: Asan (2004; 2006).

convergence of manufacturing activities (mainly output) in the more-developed states. However, until 1999, capital, labour, and output continued to be concentrated in the more-developed states. In 1999 total manufacturing output in the more-developed states was about twelve times greater than that of the less-developed states (increased from about RM3 billion in 1970 to about RM303 billion in 1999). In addition, two important indicators towards convergence — value added and output per worker — were also dominated by the more-developed states, mainly explained by the differences in investment rate, labour force growth rate, and technological progress (Asan 2006).

Although the manufacturing sector in Peninsular Malaysia as a whole has experienced rapid average annual output growth rate, its distribution remained unchanged. This phenomenon can be shown in terms of β convergence or α convergence. β convergence will occur when the less-developed states (low-income region) grow faster than the more-developed states (high-income region; the slope coefficient from regression of the growth of manufacturing output on the logarithm of its level). However, the trends of growth of manufacturing output in more-developed states and the less-developed states were parallel (both coefficients were about 0.15). In other words, there is no tendency towards convergence between the more-developed states and the less-developed states (Figure 5.7).

Meanwhile, α convergence will take place when the gap between the more-developed states and the less-developed states declines (standard deviation of the distribution of the manufacturing output across regions declines). The α convergence was in line with the β convergence. The distribution of manufacturing output across regions continued to increase (Figure 5.8). α convergence increased rapidly, especially after the implementation of the Investment Incentive Act, 1986. As was discussed in the previous part, this situation can be explained by the cessation of the location incentive scheme under Investment Incentive Act, 1972 and the location of the FTZ which focused more on export manufacturing goods, most of which were located in the more-developed states. Although under the Investment Incentive Act, 1986, FDI and domestic investment increased rapidly, they were higher in the more-developed states than in the less-developed states.

Lesser convergence between the more-developed states and the less-developed states was not only because of less FDI and domestic investment (and less growth of manufacturing output) in the less-developed states, but also because of socio-economic and demographic indicators that were dominated more by the more-developed states. This was in line with the convergence hypothesis (with more rapid convergence in countries with higher schooling levels); more schooling (as measured by male secondary attainment); higher

life expectancy, a proxy for better health and human capital in general; terms of trade improvement and resulting high FDI flows, posited to generate added employment and income; a lower government share (investment), which is posited to release resources for more productive private investment; and a lower total fertility rate, which attenuates capital-shallowing and adverse saving-rate impacts of high youth dependency (Kelley and Schmidt 1998, p. 23).

Manufacturing activities in the more-developed states concentrated more on export-oriented (mainly electronic and machinery industries) products, while manufacturing activities in the less-developed states were more concentrated on resource-based (wood and rubber) products and food industries, which were more for the domestic market. Convergence is stronger among countries that have strong trading relationships (Ben-David 1996). However, trading of manufacturing products within the more-developed and the less-developed states was relatively low.

Other factors that could have resulted in convergence between the more-developed states and the less-developed states in Peninsular Malaysia did not arise due to the diffusion of technological change that was more dominant in the more-developed states. Besides the higher secondary education levels which facilitated the absorption of new technologies in the more-developed states, capital-intensive industries were also concentrated in the more-developed states. Technology transfers (mainly by FDI), large firm size, and human resource development (HRD; education and training), as well as accumulation of knowledge through research and development (R&D)[11] drove faster productivity growth in the more-developed states (Asan 2006).

Low R&D and HRD not only caused low total factor productivity (TFP) but also less output elasticity of labour and capital in the less-developed states (Table 5.19). Labour and output in the less-developed states were less efficient compared with the more-developed states. However, government intervention by increasing the capital flow in government subsidiary companies in the less-developed states showed a good response. In the period 1994–1995, the output elasticity of labour in the less-developed states was greater than that of the more-developed states. In other words, more capital flowed to the less-developed states in the process of convergence across regions.

Overall, the manufacturing sector in Peninsular Malaysia showed no tendency towards convergence between the more-developed states and the less-developed states. The growth trend of manufacturing output across regions (β convergence) remained unchanged, while the distribution of the manufacturing output across regions (α convergence) increased continuously. The convergence process in Peninsular Malaysia was limited because of several factors, such as disadvantages in the demographic indicators; less trading

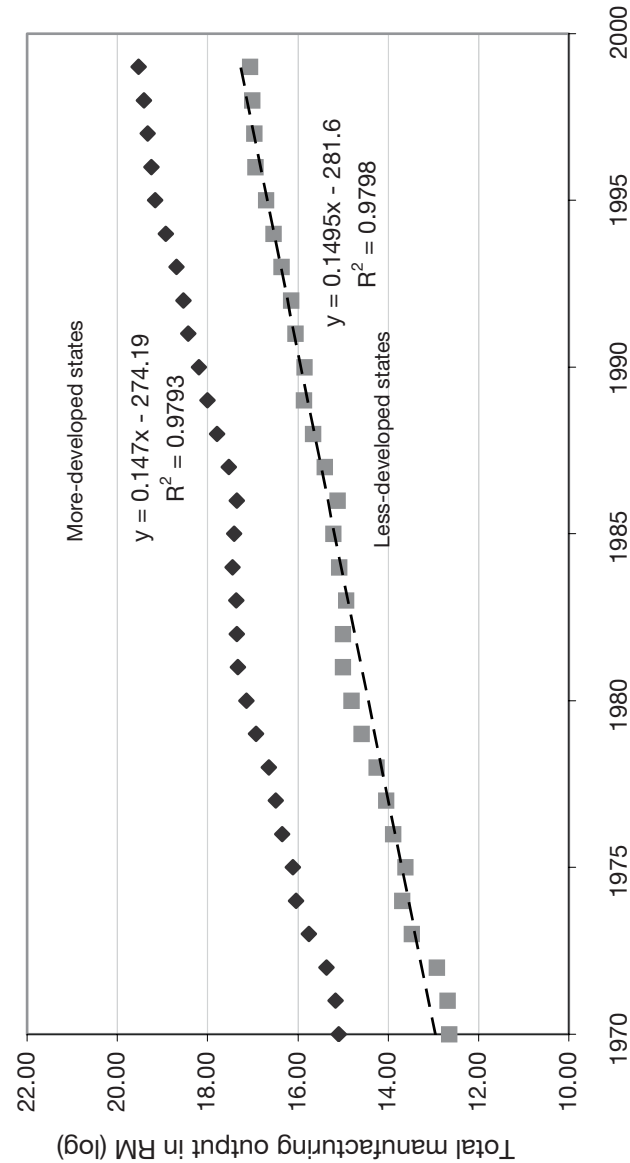


FIGURE 5.7
The β Convergence

Source: Asan (2004; 2006).

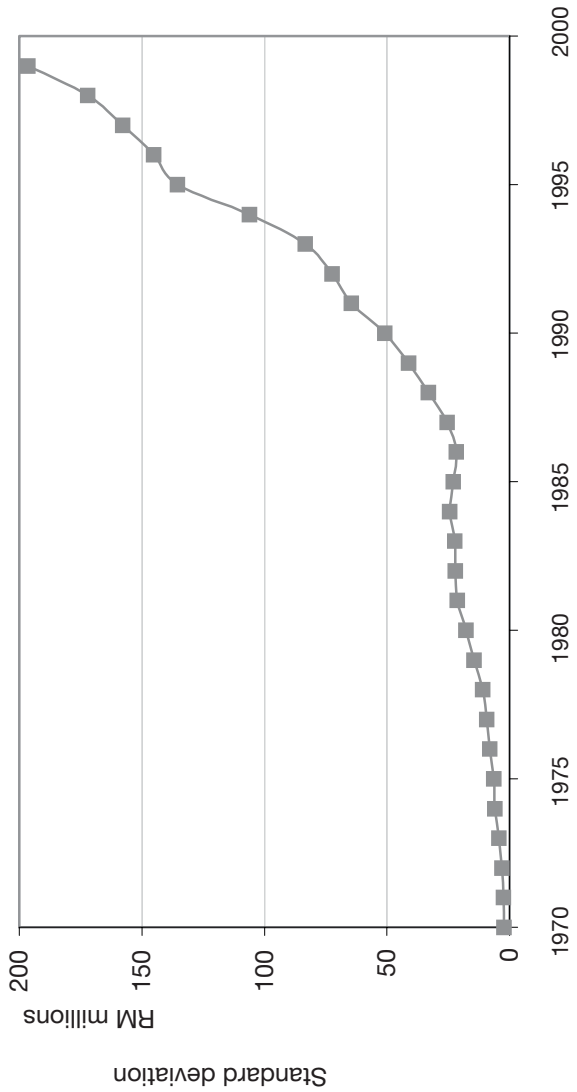


FIGURE 5.8
The α Convergence

Source: Asan (2004; 2006).

TABLE 5.20
Capital and Labour Efficiency, 1990–91 and 1994–95

	Output elasticity of labour		*Output elasticity of capital*	
	MDS	*LDS*	*MDS*	*LDS*
1990–91	1.606	1.082	0.972	0.657
1994–95	1.702	1.287	1.019	1.119

Notes: Output elasticity of labour = $\frac{\partial Y/\partial L}{L/Y}$

Output elasticity of capital = $\frac{\partial Y/\partial C}{C/Y}$

∂ = change in Y, L or C in that particular year
Y = output in RM
L = number of labour
C = number of capital

Sources: Asan (2004; 2006).

between states; slower diffusion of technological change; less HRD, R&D, and low productivity growth (TFP); as well as less efficiency of labour and capital in the less-developed states.

CONCLUSION

Since 1956, under the First Malaya Plan, and especially after 1970, the manufacturing sector was seen as the main tool to spearhead the restructuring of economic activities across regions. This is because industrial imbalance has an important relationship to the imbalance of household monthly income, poverty, and unemployment. An industrial dispersal strategy was incorporated in the five-year Malaysia plans. In order to promote industrial activities in the less-developed states, the government introduced the concept of "development areas" under the Investment Incentives Act, 1968; "location incentive schemes" under the Investment Incentive Act, 1972; and "East-Coast Corridor" under Investment Incentive Act, 1986. Industries located in particular areas received benefits through tax holidays and investment allowances that were attractive to private investors. It was hoped that these incentives would increase manufacturing activities in the less-developed states which recorded less monthly income, high poverty and unemployment as well as out-migration.

However, the location incentives were less effective; projects approved under these incentives were small compared to other incentives — they only accounted for less than 3 per cent of the approved manufacturing projects

with incentives. Most industries were still located in the more-developed states mainly due to established manufacturing activities in those areas with easy access to infrastructure, service industries, and large labour and consumer markets. Although the cost of land (industrial areas, especially developed by the private sector) in the more-developed states was relatively high, the investors were still willing to locate their firms in the more-developed states after taking into consideration the deduction of production costs from the location incentives if the firms were to be located in the less-developed states. The relative advantage of positioning the firms in the more-developed states was greater than that of the location incentive.

One disadvantage in the redistribution of manufacturing activities in Peninsular Malaysia was due to the FTZ industries strategy. Investors in the FTZs were mainly foreign direct investors, export-oriented, and capital-intensive industries. Since 1970 the FTZs were located in the more-developed states mainly due to the infrastructure network, which provided easy access to service industries. The FTZs were developed near to the well-established industrial estates and infrastructure network mainly to generate backward and forward linkages to other industries and to make them more attractive to FDI. Because the FTZs were more oriented to export products, it was more convenient to locate them near ports. However, the major ports in Peninsular Malaysia were located in the more-developed states; Port Klang in the state of Selangor and Pasir Gudang Port in the state of Johor (beside the Port of Singapore).

Even though the number of existing industrial estates in the less-developed states has increased, the area they cover is small, and they were all developed by the government. The industries located in the less-developed states are small and medium industries that are labour intensive. They are largely resource-based (wood and rubber) and food manufacturing industries focused on domestic products rather than export-oriented, while the more-developed states concentrate more on electronics (and machineries). These industries are capital-intensive and export-oriented (mainly dominated by FDIs in the FTZs).

Labour intensive industries showed more dispersal across regions (such as food, beverages, and tobacco, wood products, rubber industries, and non-metallic minerals), while high-technology industries (such as textiles and clothing, paper, printing, and metal products) remained concentrated in the more-developed states. This scenario has a close linkage with the background of the labour market in that particular state. Although the FDI was more dispersed compared with domestic investment, the numbers in the less-developed states were still low and were more on labour-intensive manufacturing activities, mainly because the cost of hired labour was relatively cheap.

Even though total manufacturing output in Peninsular Malaysia experienced rapid annual growth, its distribution remained unchanged. In other words, there is no tendency towards convergence between the more-developed states and the less-developed states. It seems that there was an economic and demographic "disadvantage cycle" which occurred in the less-developed states. This cycle is shown in Figure 5.9.

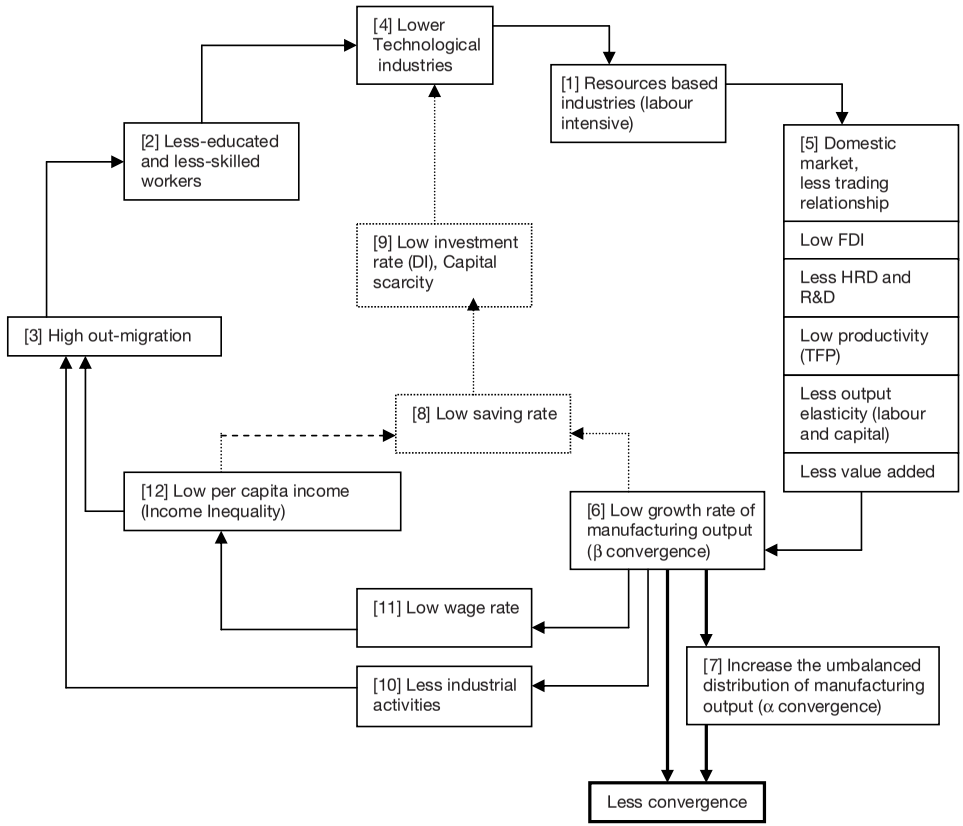
Most of the manufacturing activities in the less-developed states were resource-based and labour intensive industries [1]. These activities have a close linkage with the background of the labour supply in that particular state [2]. This is because educated and experienced workers have migrated to the developed states [3], which created a lower technological industrial environment in the less-developed states [4].

The resource-based and the labour intensive industries were owned mainly by the domestic investors and their products were also for the domestic market (FDI activities were more capital intensive and focused on export-oriented products) [5]. The lower technological industrial environment, small firm size, less HRD and R&D, less output elasticity of labour and capital, and less value added slowed the TFP growth. It is undeniable that all these factors have caused a low growth rate of manufacturing output (β convergence) in the less-developed states [6] and increased the unbalanced distribution of manufacturing output (α convergence) across regions [7].

On the investors' side, a low growth rate of manufacturing output means less marginal profit as well as lower savings [8]. In this scenario, less-developed states also faced the problem of capital scarcity and they chose to invest in manufacturing that used less capital as well as less technological components as the best solution [9]. Besides that, less marginal profit (because of the low growth rate of manufacturing output) was the important factor in why there were less industrial activities in the less-developed states [10], while on the labour side, less marginal profit (because of the low growth rate of manufacturing output) has a strong linkage with the low wage rate [11], low monthly per capita income, and low saving rate in the less-developed states [12]. Less industrial activities as well as monthly per capita income (because of the low wage rate) then caused high out-migration to the developed regions [3]. Only those with less education and experience will remain in the less-developed states, and finally the cycle will start again.

In conclusion, based on the disadvantage cycle, it was difficult for the government to increase manufacturing activities in the less-developed states, especially the capital-intensive industries. Most of the industries were labour-intensive, which recorded low productivity and output growth rate

FIGURE 5.9
"Disadvantage Cycle" in the Less-developed States


[4] Lower Technological industries
[1] Resources based industries (labour intensive)
[2] Less-educated and less-skilled workers
[5] Domestic market, less trading relationship
Low FDI
Less HRD and R&D
Low productivity (TFP)
Less output elasticity (labour and capital)
Less value added
[9] Low investment rate (DI), Capital scarcity
[3] High out-migration
[8] Low saving rate
[12] Low per capita income (Income Inequality)
[6] Low growth rate of manufacturing output (β convergence)
[11] Low wage rate
[10] Less industrial activities
[7] Increase the umbalanced distribution of manufacturing output (α convergence)
Less convergence

Source: Asan (2004, 2006), Hasnah and Asan (2008).

which then slowed the process of convergence in the less-developed states. Three strategies have been implemented to overcome the above problems. The strategies were to increase the quality of life, including education and infrastructure; giving extra incentives for the capital-oriented industries; and to increase government investment in the subsidiary companies in the less-developed states. However, due to the disadvantage cycle (Figure 5.9), the convergence process in the less-developed states remains unchanged.

Increasing education and infrastructure in this scenario in which the industrial activities in the less-developed states remain unchanged (less number of industries and low wage rates) make the out-migration continue to increase. Further incentives (under the Investment Incentive Act) for the capital-oriented industries to be located in the less-developed states were also unsuccessful mainly because the workers were less-educated and experienced. Finally, even though the government has invested in the subsidiary companies (capital-intensive industries) in the less-developed states, those industries were more capital driven with less contribution to the TFP. It did not help much in the process of convergence because of the low growth rate of the manufacturing output.

CLOSING REMARKS

Regional disparities, income inequality, and poverty are interrelated issues mostly discussed in development economics. They are important issues that stem from a lack of economic growth and thus are dealt with by governments all over the world through various development policies.

To an extent, the development policies of the Malaysian Government have been able to address these issues successfully. Poverty has decreased sharply, standards of living among Malaysians and within each ethnic group have improved, and unemployment decreased in all regions. However, most industries, especially those capital intensive and export-oriented ones, are still located in the more-developed states mainly due to established manufacturing activities in those areas with easy access to infrastructure, services industries, and large labour and consumer markets. The advantages of positioning firms in the more-developed states is greater than any advantages of setting up firms in the less-developed states.

In order for policymakers to make better development policies to bridge the gap between the more-developed and the less-developed states, we believe that a better understanding of the disadvantage cycle that is occurring in the less-developed states is necessary. Previous development policies were shown to be inadequate to bridge this gap. A better understanding of the constraints

in the disadvantage cycle might help policymakers to come up with a more holistic development policy that could narrow this gap.

Notes

1. The NEP was developed based on the recommendations by the Department of National Unity (DNU), Economic Planning Unit (EPU), the Treasury, Malaysia's Central Bank, Department of Statistics, and the Federal Industrial Development Authority (FIDA) in the period 1969–1970. Please refer to *"The Birth of a New Development Strategy"*, in Faalan et al. (2003, pp. 25–73; 250–423).
2. In the 1991 Census, urban areas were defined as gazetted areas with their adjoining built-up areas, which had a combined population of 10,000 or more. Built-up areas were defined as areas contiguous to a gazetted area and having at least 60 per cent of their population (aged 10 years or more) engaged in non-agricultural activities and at least 30 per cent of their housing units having modern toilet facilities. In the 1970 and 1980 censuses, the urban definition was only restricted to the gazetted areas with a population of 10,000 and more (Government of Malaysia 1995, pp. xvii and 29).
3. Primacy Index (PI) refers to the rank size rule and measures the concentration of population in the primate city in relation to the rest of the cities. Increase in PI means increase in concentration of population in the largest city. PI = $C_i/; \sum C_k$; where C_i is the population of the largest city and C_k is the population of the *k* city, *k* = 2,3… n. Metropolitan towns refers to urban areas with a minimum population size of 75,000 persons. In 2000, there were 40 metropolitan towns in Malaysia, but only 13 were located in the less-developed states (Siti 2007).
4. Poverty in Malaysia is primarily a rural phenomenon. Within each ethnic group, rural residents are more likely to be poor. Rural Malays and rural Indians are the two most poverty-prone subgroups; in both rural and urban subsets, Chinese are the least poverty-prone (Kusnic and DaVanzo 1982, p. 25).
5. The incentives provided for industries to locate in a development area are linked to some of the incentives provided under the Investment Incentives Act, 1968. For pioneer industries locating in a development area, an additional year of tax relief is granted irrespective of the size of the capital investment. Also, should an electronic firm which enjoyed the special incentive from the electronic industry be located in a development area, it becomes eligible for an additional year of tax relief. For a company that had been granted the investment tax credit (ITC), an additional credit of 5 per cent of the approved capital expenditure would be granted if the company is to be located in a development area (Lee 1978, pp. 456–58).
6. In addition to the "development area" in the Investment Incentive Act, 1968, any industry located in the gazetted location incentive scheme becomes eligible for five years of tax relief compared with three years tax relief if the industry is located in the development area. Areas covered under the Location Incentive

Act overlapped with locations under the development area in the Investment Incentive Act, 1968.

7. It was hoped that these additional incentives would decrease the cost of production. States on the east coast of Peninsular Malaysia recorded less comparative advantage in terms of concentration of population (consumer), labour force (high out-migration, especially those who are experienced and educated), and social infrastructure.
8. In 1996 (July), from 4,403.47 total hectares of industrial land developed under Johor State Economic Development Corporation (SEDC), only 16.59 hectares (0.38 per cent) were located at Mersing Industrial Estate (Mersing I). While, in 1998 (January), of 4,443.78 total hectares of industrial land developed under SEDC, only 1,500 hectares (0.33 per cent) were located at Mersing Industrial Estate (Mersing II).
9. For example, under Investment Incentive Act, 1986, a company granted Pioneer Status will enjoy partial exemption from the payment of income tax. It will only have to pay tax of 30 per cent on its statutory income. The period of tax exemption is five years; however, as an added incentive, companies located in the designated Eastern Corridor of Peninsular Malaysia will only have to pay tax of 15 per cent on their statutory income during the tax exemption period of five years. A company granted Investment Tax Allowance will be given an allowance of 60 per cent on the qualifying capital expenditure incurred within five years from the date on which the first qualifying capital expenditure is incurred. The allowance can be utilized to offset against 70 per cent of the statutory income in the year of assessment. Any unutilized allowance can be carried forward to subsequent years until the whole amount has been used up. The balance, i.e., 30 per cent of the statutory income, will be taxed at the prevailing company tax rate. As an added incentive, companies located in the designated Eastern Corridor of Peninsular Malaysia will be granted an allowance of 80 per cent on the qualifying capital expenditure incurred. The allowance can be utilized to offset against 85 per cent of the statutory income in the year of assessment (MIDA 2009).
10. The term FTZ was used under the Investment Acts 1968, 1972, and 1986. However, those acts have been revised and restructured under a new act, Free Zones (FZ) Act 1990. Free Zones consists of Free Trade Zones (the current meaning of FTZ is different from the previous FTZs mentioned in the Investment Acts 1968, 1972, and 1986), Free Industrial Zone (FIZ is similar to the previous FTZ in the Investment Acts 1968, 1972, and 1986), and Free Commercial Zone (FCZ). A Free Zone is an area declared by the Minister of Finance under the provision of Section 3(1) of the Free Zones Act 1990. It is mainly designed to promote entrepôt trade and specially established for manufacturing companies that produce or assemble products mainly for export. A Free Zone comprise a free commercial zone for commercial activities which include trading (except retail trading), breaking bulk, grading, repacking,

relabelling and transit, and a free industrial zone for manufacturing activities. The activities and industries therein are subject to minimal customs formalities and it is deemed as a place outside the Principal Custom Area except in respect of Prohibition of Imports and Exports under Section 31 of the Customs Act 1967. To date there are 13 FCZs located at the North, South, and West Port of Port Klang, Port Klang Free Zone, Pulau Indah MILS Logistic Hub, Butterworth, Bayan Lepas, KLIA, Rantau Panjang, Pengkalan Kubor, Stulang Laut, Johor Port, and Port of Tanjung Pelepas. Other than minimal customs formalities, FIZs enable the export-oriented companies to enjoy duty-free import of raw materials, component parts, machinery and equipment required directly in the manufacturing process, as well as minimal formalities in exporting their finished products. To date there are 16 FIZs located at Pasir Gudang, Tanjung Pelepas, Batu Berendam I, Batu Berendam II, Tanjung Kling, Telok Panglima Garang, Pulau Indah (PKFZ), SungaiWay I, SungaiWay II, Ulu Kelang, Jelapang II, Kinta, Bayan Lepas I, II, III, Bayan Lepas IV, Seberang Perai, and Sama Jaya. Companies can be located within FIZs when their entire production or not less than 80 per cent of their products are meant for export and their raw materials/components are mainly imported. Nevertheless, the government encourages FIZ companies to use local raw materials/components (MIDA 2009).

11. In 1989, the country's R&D expenditure was 0.8 per cent of GDP. Of this total, 20 per cent was contributed by the private sector, which was made up mostly of foreign entities (FDI) (Government of Malaysia 1991*b*, p. 211).

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6

THE MOBILITY GAME IN SINGAPORE
Poverty, Welfare, Opportunity, and Success in a Capitalist Economy

Tan Ern Ser

By now, most studies on social mobility have consistently demonstrated that family background matters (Chen 1973; Quah et al. 1991). What fathers do for a living has a strong influence on how their children perform in school and eventually in the labour market. There are obviously a host of other contributory factors which can enhance one's mobility chances; however, they all boil down to the fact that a person's access to economic, social, and cultural capital[1] has a significant impact on his or her future career and life trajectory.

My own study (Tan 2004), as well as that of Chen (1973) and Quah et al. (1991) before me, also suggest that despite official policy aimed at equalizing opportunities in Singapore, family background continues to have a strong influence on educational and occupational attainment among Singaporeans. Indeed, Ko (1991, p. 224) found that "about one fifth of the variance in education may be explained by the three background variables (father's education, father's occupation, and mother's education)". This is hardly surprising, given that for practical reasons the provision of opportunities tends to focus primarily on economic capital, rather than social and cultural

capital. In other words, even if economic capital could be equalized, it is unlikely that one could prevent the advantages associated with social networks, such as kinship and friendship ties, and access to knowledge and information from boosting the mobility chances of offspring of well-connected, well-educated parents.

I am not suggesting that people without the appropriate credentials and merits, academic and otherwise, could climb up the social ladder simply by hanging on to the coattails of their parents, but that, all things being equal, social and cultural capital may well tip the balance in one's favour. Consequently, meritocracy is not compromised. However, there is one important exception to this principle. Because of the institution of private property inheritance, a key feature of capitalist society, one could become a business owner simply by being born into wealth, and paradoxically be in a position to hire and control people with credentials, but without the privilege of family wealth.

USING A GAME ANALOGY

In this chapter I will not continue to prove ad nauseam that family background matters or that the policy and practice of equalizing opportunities, or even economic growth with job creation, has led to greater absolute mobility or even relative mobility. Rather, I will be using a game analogy as a tool to understand social mobility and the related issues of poverty and welfare in Singapore. This approach provides a useful conceptual device for connecting various mobility-related factors and processes in a way which can help us identify the challenges facing, and extrapolate the future of social mobility in, Singapore.

To begin with, a game is characterized by having rules, goals, and players with differing abilities and motivations. It specifies how the game is to be played and the processes that one needs to go through in order to win at the game. It also provides resources and opportunities accessible to players, though there is nothing to stop players from mobilizing their own or family resources to perform well in the game.

The mobility game has different categories of winners and losers, as well as players who fall by the wayside. It allows the possibility of people opting out of the game for lack of interest, motivation, ability, or resources. However, this is not to suggest that the people who exit the game have necessarily abandoned their mobility aspirations; rather they may have decided to move overseas in search of "greener, user-friendly pastures" wherein to participate in some other countries' mobility games. The advent of globalization has in fact

facilitated this process, even as it encourages the inflow of foreigners, thereby increasing the number of players or competitors involved in the Singapore mobility game. However, not everyone needs to participate in the mobility game. There is a small category of non-players, people who could afford not to play the game because they are independently rich through past successes or through inheritance, or a combination of both of these.

Apart from having a multiplicity of different kinds of players or non-players, another interesting aspect of the game is that it is somewhat structured, yet compatible with the notion of self-reliance. This appears to be a contradiction, but only seemingly so, because while most Singaporeans believe in and are expected to be self-reliant, they depend on the government to ensure that the mobility game and its structure of opportunity remain viable.

I shall now describe the mobility game in Singapore from a historical perspective and discuss the changes that have taken place.

THE MOBILITY GAME IN SINGAPORE: FACILITATING SUCCESS

For much of its known history, Singapore has been a society of migrants, though the net immigration figures vary from time to time, depending on policies and economic conditions, local, regional, and global. By and large, immigrants come to Singapore to seek better opportunities for themselves and their children, just as Singaporeans leave their homeland in search of greener pastures elsewhere.

Some immigrants did become enormously wealthy, thereby becoming the subjects, even folk heroes or icons, of popular history. Because theirs were "rags to riches" stories, similar to those of Horatio Alger in the United States, their life-histories not only become an inspiration to others, but also point to the possibility of long-range upward social mobility in Singapore, understood as a land of opportunity (cf. Chinoy 1955).

In reality, however, the probability of long-range upward mobility is quite small. But this fact is not a serious concern, since what matters is that the "rags to riches" stories convey a strong sense that Singapore is an open class, meritocratic system where one's station in life does not have to be permanent, and that one could take control of one's destiny through sheer hard work and determination. This is in fact the fundamental principle of the mobility game, that social background is not destiny and that there are ample opportunities available to whoever has the ability and motivation to propel themselves upwards.

In the Singapore context, the state has been and is the controller and manager of the mobility game. It sets the rules and provides much of the resources and opportunities necessary to play the mobility game. It has also taken on the responsibility of ensuring that there are sufficient rewards to keep the mobility game meaningful and viable. Specifically, the rule of the game can be summarized in one word — meritocracy, or reward for merit in educational and job performance. The resources and opportunities refer to access to good quality, subsidized education unrelated to ability to pay, as well as middle-class jobs.

Consequently, while opportunities are not exactly equal, as I have explained earlier, many Singaporeans, regardless of family backgrounds, have been able to move up the educational ladder, receiving at least a secondary education and, increasingly, even a tertiary education. There is no doubt that a high and growing proportion of Singaporeans have availed themselves of the opportunities and managed to move up the social ladder. Coupled with the very successful economic strategies that have produced spectacular economic growth rates worthy of an Asian Tiger and contributed to employment creation, the policy of equalizing opportunities has led to Singapore becoming a middle-class society characterized by growing affluence and a rising standard of living comparable to that of First World countries (Lee 2000). In short, Singapore has had a viable mobility game in which all players have a fair chance of winning, in the forms of attaining decent jobs and a reasonably high, but accessible standard of living, regardless of starting points.

It is clear that the viability of the mobility game hinges largely on the ability of the economy to consistently deliver sufficient, decent-paying — even high paying — jobs which match the aspirations and expectations of young Singaporeans armed with educational credentials. For those with university education, the expectation upon graduation is not to obtain merely a job, but to embark on a secure, middle-class career trajectory.

Based on the above criteria, I would argue that the late seventies and early eighties constitute the golden age of the mobility game in Singapore. That was the period of double-digit growth rates, phenomenal employment creation, large bonuses and annual wage increments, together with a tight labour market where job-hopping, rather than unemployment, was a national concern. That period also corresponds to when the five C's (cash, credit card, condominium, car, club membership), which symbolize the good life and the Singapore equivalent of the American Dream, first came into vogue in the popular imagination of most Singaporeans.

At the level of everyday life, most Singaporeans were caught up with the idea of upgrading, or doing better intra- and intergenerationally.

This upgrading mentality is focused on at least two "big ticket" items: moving to a larger HDB[2] apartment — if possible, even crossing the visible and symbolic class divide between public and private housing — and purchasing an automobile.[3] In sociological terms, the language of upgrading translates into upward social mobility involving working class persons or families joining the swelling ranks of the middle class, thereby contributing to the transformation of Singapore into a middle-class society.

Within this middle-class society, living in smaller sized HDB apartments, that is, three-room or smaller flats, was getting out of fashion, while the demand for private condominium apartments rose substantially to such an extent that even the HDB felt obliged to design and build so-called middle-class housing (executive apartment blocks, followed by executive condominiums).[4]

At the same time, the government agonized over how best to meet the automobile aspirations of Singaporeans, without at the same time allowing too many cars on already crowded roads, even as it focuses much attention on the issue of enhancing company loyalty and productivity via company welfarism, organizational culture, and lifetime employment — long before the term "lifetime employability" became fashionable. Because these were seen as the factors contributing to the Japanese economic success story in the seventies, it is no wonder that Japan was touted by academics — a prominent example being Vogel (1979) who wrote the bestseller "Japan as Number 1" — and policymakers as a model worthy of emulation.

THE MOBILITY GAME IN SINGAPORE: DEALING WITH POVERTY AND WELFARE

Not surprisingly, that period saw poverty as an issue taking a backseat as droves of Singaporeans played the mobility game, having full confidence that individual self-reliance and government-sponsored opportunities constituted the formula for achieving the Singapore Dream. Poverty is therefore deemed to reflect moral shortcomings, in the forms of laziness and irresponsible behaviours or, somewhat more generously, to bad luck, misfortunes, or lack of natural ability, causing some to fall through the cracks, rather than a failure of the system, which in the Singapore case refers to capitalism, to deliver decent-paying jobs, and the mobility game, which is perceived to be fair, equitable, and viable.

Correspondingly, poverty and low income are seen as the absence of mobility that could be addressed by measures aimed at "levelling up",[5] rather than at redistribution or even narrowing income inequality. I must add that

while inequality is generally seen as socially undesirable, it is not exactly a "dirty" word — even if politicians sometimes feel obliged to condemn it in public statements — since support for capitalism and meritocracy presupposes unequal rewards and outcomes as the basis for motivating people to seek to perform well in roles that contribute to economic growth and well-being. This mirrors the functionalist perspective on social stratification,[6] which is generally thought to be theoretically problematic but comes across as sensible and ideologically defensible.

I should also point out that this ideology, when reinforced by numerous success stories of upward social mobility, also provides the justification for the approach to welfare provisions adopted in Singapore. The rhetoric is that a good welfare policy is one that provides opportunities for Singaporeans to become self-reliant materially, rather than one which inculcates a "handout" mentality. Hence, we often hear the cliché that rationalizes why welfare policies should aim at "teaching a person to fish", which will enable him to take care of himself, rather than "give him fishes", which will encourage dependency at the level of individuals and families, and in turn an unsustainable welfare system, albeit with good intentions, but incapable of delivering on its commitments in the longer term.

THE MOBILITY GAME TOUGHENED IN SINGAPORE

From the discussions above, the fundamentals of the mobility game do come across as primarily sound, viable, and sustainable. Unfortunately, while the game is internally consistent, logical, and reasonable — thereby enjoying a high degree of legitimacy — it is not entirely foolproof. For one thing, the decent-paying jobs — including middle-class jobs — are expected to be delivered in sufficient quantity, but may be harder to come by as a result of global recession or competition. This concern is succinctly reflected in the serious tones resonating throughout the pages of the report issued by the high-powered Economic Review Committee (ERC) chaired by then Deputy Prime Minister Lee Hsien Loong (Singapore, ERC, 2003).

Moreover, as noted earlier, it is not practical under capitalism, which treats private ownership, inheritance, and market as sacrosanct, to bring about a totally level playing field. Some players would enjoy higher advantages via their access to economic, social, and cultural capital than others. Nevertheless, as long as the game manager is able to "pump" in sufficient prizes, it does not really matter that some are moving faster and further than others because they have access to more resources. As long as players feel that they are experiencing some degree of upward mobility and be able to upgrade their

material well-being periodically, they would continue to have confidence in the mobility game, despite the imperfections.

This seems to be the orientation that Singaporeans adopt towards the mobility game. Obviously, during the golden age of the mobility game in the late seventies and early eighties, their confidence did have a strong basis. Since the 1985–86 recession, however, the cycle of "boom and bust" seems to operate at shorter intervals. Over the last quarter a century, from 1985 to 2009, Singapore has experienced the economic repercussions caused by the 1997 Asian financial crisis, the 11 September terrorist attacks in the United States in 2001, and, recently, the housing sub-prime crisis and tremendous financial meltdowns. As we are all very familiar by now, recessions and meltdowns do bring about a trail of destruction, manifested in the form of job and income insecurity and erosion of retirement savings, affecting both individuals and families.

In the earlier economic crises, the general perception was that working-class jobs were the least secure as the Singapore economy embarked on the process of restructuring to face the challenges of global competition. So long as this view was prevalent, it did not affect the fundamentals and the perceived viability of the mobility game. However, in the recent economic meltdown, which has led to a contraction of the economy, people in middle-class jobs — collectively known as PMETs, or professionals, managers, executives, and technicians — also experienced retrenchments in significant numbers (*Straits Times*, 8 March 2009; *Today*, 17 March 2009). The fact that PMETs received much attention in Budget 2009 and media reports provides a strong indication that job and income security is no longer primarily a working-class affliction, but one that affects middle-class people as well.

It does seem that the secure, comfortable middle-class career trajectory is now a thing of the past, given the changed global economic environment characterized by frequent fluctuations and intense competition, which entail economic restructuring and flexibility. Instead of a clear career ladder, middle-class aspirants often find themselves having to compete very hard for contract positions. Once in a job, they are constantly subjected to performance evaluation and expected to be adept at multitasking, yet to not expect employment security. Where lifetime or at least long-term employment was once the norm, they are now expected to constantly upgrade their skills, or even to re-skill, in order to stay employable, failing which they could face the prospect of redundancy or skills obsolescence in middle-age (Hing 1997, p. 106). Moreover, the fact that one could suffer job loss in middle-age does multiply the problem several fold, given that ageism may rear its ugly head in subtle, muted forms.

Most certainly, the mobility game is no longer an easy game to play, nor are the rewards a high degree of security and a comfortable middle-class existence; yet the option to drop out of the mobility game is not a realistic one. For one thing, most Singaporeans have committed themselves to acquiring the trappings of a middle-class lifestyle, which includes home ownership and, in some cases, automobile ownership as well. Moreover, if they happen to be in the sandwiched generation,[7] they would have ageing parents with longevity and long-term adolescents as dependents. To add to this problem, the ageing parents may not be in good physical health and therefore in need of constant medical attention, often without the benefit of health insurance. At the same time, they are committed to helping their children succeed in the mobility game. This entails having a budget to ensure that their children perform academically well enough to eventually enter university, preferably the highly subsidized local ones.

THE MOBILITY GAME: EVALUATION AND POLICY RECOMMENDATIONS

When assessing the mobility game, I recognize that hindsight is usually better than foresight. During the golden age of the mobility game, when the economy had just emerged from a low base and when the demographic profile was much younger, it was relatively easy to develop and sustain a viable mobility game and perhaps think that the good times could continue indefinitely. At the level of individuals, the mobility game was also easier to play and the probability of attaining a secure, comfortable middle-class career trajectory and lifestyle fairly good. Consequently, Singaporeans were totally obsessed with the idea of upgrading and achieving the "good life", the Singapore-equivalent of the American Dream. To be sure, a large and growing proportion of Singaporeans did succeed in the mobility game.

Unfortunately, while Singaporeans were preoccupied with climbing up the "ladders", they did not pay much attention to the "snakes", such as medical costs for ageing parents, education costs of long-term adolescent children, and meltdowns of personal assets, nor did they entertain the thought that job and income security, and in turn the middle-class lifestyle, may be far less permanent than they had always thought.[8] Downward mobility in middle-age may turn out to be the cruel reality where an earlier generation had looked forward to enjoying the fruits of their labour in old age. Perhaps, during the golden years of the mobility game, very few of the upgraders or upwardly mobile really understood that the mobility game could someday — soon — lose its glitter, and that while they focus on asset-building, they did not

notice that their liabilities constitute a potential time bomb ready to explode at a time when they are least able to respond.

I am not sure if the upgraders would fall low enough to benefit from assistance normally extended to the poor or low-income. I believe they would do all they can to cling on to their middle-class lifestyle, rather than allow themselves to sink into a lower class.

In my view, given that the legitimacy of the government depends on its ability to maintain the viability of the mobility game, more than its ability to help those who fall by the wayside, it makes sense for the government to ensure that even as Singaporeans are advised to and given the opportunity to stay employable, that there will always be sufficient middle-class jobs.

Moreover, the government should also extend more help towards current middle-class, middle-age people in the sandwiched generation, thereby enhancing their capacity to handle some of the liabilities (for instance, medical costs of their elderly parents, and perhaps even grandparents) they happened to inherit, with some degree of assurance that they would not lose a large chunk of what they have gained from diligently playing the mobility game over the years.

I believe that because the government's legitimacy lies in its ability to maintain Singapore as a middle-class society, it must do its utmost to ensure that Singapore does not turn back to becoming a working-class society. I am not sure if this is too much or unreasonable to ask or am I just being unrealistic and unnecessarily nostalgic of a past that can never return.

Let me also venture to suggest something which could be deemed quite outrageous and may even smack of elitism. I have observed that "problem families"[9] do not have the capacity to help their offspring play the mobility game. While it is commendable that the state has taken upon itself to help "problem families" and their offspring, I cannot help but think that Singaporeans ought to do some serious financial budget planning before they decide to start a family; otherwise, not only would this result in themselves and their offspring being incapable of playing the mobility game, but they may also end up in the poor or low-income category and needing welfare on a long-term basis.

Notes

1. Economic capital includes financial assets or resources; social capital refers to the advantages derived from social networks, connections or ties; while cultural capital refers to educational credentials and useful knowledge, including linguistic competence (Bourdieu 1984).

2. HDB is the abbreviation for Housing and Development Board, the public housing authority.
3. Purchasing an automobile could also be understood as crossing the visible and symbolic class divide between public and private modes of transportation.
4. A crude indicator of how flat size corresponds to class is median household income. That of residents of one-room to three-room flats is below the national median household income of $4,950 in 2008 (Department of Statistics 2009). Based on this criterion, those residing in four-room or larger HDB flats could be considered "middle class", while those in private housing, "upper middle class".
5. "Leveling up", together with "sharing success", is in fact the key theme of an official publication released by the Ministry of Information and the Arts (MITA 1996). This booklet focuses on key social programmes established by the Singapore Government.
6. The functionalist perspective argues that higher rewards are necessary to motivate people to assume the "functionally more important positions" in society.
7. The term refers to those who are in an unenviable position of having to take care of elderly parents and schooling children.
8. I am using the analogy of the game of "snakes and ladders" in which the former leads to regression, while the latter allows progression to the end-point.
9. By "problem families", I have in mind family units set up by couples who are incapable of looking after themselves, yet went on to produce children who are exposed to an environment severely lacking in economic, social, and cultural capital.

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7

POVERTY IN DEMOCRATIZING INDONESIA

Aris Ananta and Evi Nurvidya Arifin

INDONESIA'S ECONOMIC CRISES

> It was a global phenomenon, not unprecedented, and not totally unexpected. Economic histories had shown the frequency of a boom followed by a slump. Business persons and economists had actually observed hints of an avalanching financial crisis. Yet, they thought that the phenomenon would weed the economy from less viable economic elements and would result in a much strengthened economy. On the contrary, the phenomenon had turned out to be an extremely long and severe, calamitous economic situation.
>
> Life was like a roller-coaster with one difference. This ride has no predictable end. People used to enjoy prosperity and rising expectation, with many plans for the years ahead. Suddenly and dramatically, their wealth, at least on paper, plummeted. They might have discussed poverty earlier, but they never experienced being poor, though they were still far from [at a] subsistence level. Statistically, they were not recorded as "poor" but they felt terribly poor. Another distinguishing character is that they had [a] strong political voice. They mostly included the elite, such as scholars, politicians, bureaucrats, business persons, journalists, and those who work in NGOs.

These two paragraphs may sound like they are describing the recent global great recession starting in July 2007 in the United States and deepening and

widening worldwide since 2008 until the first half of 2009. In fact, the first paragraph is a description from O'Malley (1977, p. 60), when he portrayed the economic situation in pre-independence Indonesia during the 1930s, the time when the world suffered from the Great Depression. Indonesia had witnessed spectacular economic growth during the first three decades of the twentieth century, particularly compared with the last two decades of the nineteenth century. Then, the worldwide Great Depression, starting from the United States, crushed Indonesia's booming prosperity. It should also be noted that the global 1930s crisis had contributed to rising nationalism in Indonesia and resulted in the independence of Indonesia in 1945.

Meanwhile, the second paragraph is a picture of Indonesia during the severe 1997–98 Asian crises depicted in Ananta (2003, p. 8). Yet, Indonesia generally enjoyed a remarkable economic success under the New Order era (before the crisis) with the economy growing by an average of 8 per cent annually from the late 1980s. In the first half of 1997, inflation was relatively low, the balance of payments was strong, and the exchange rate remained low. There was, at that time, few macroeconomic signs that the economy would plunge into turmoil. Then, shattered by a regional crisis starting in Thailand, Indonesia was affected by a very heavy regional crisis. It became a total crisis — economic, social, and political crises — for Indonesia. Economic growth dropped to minus 13.1 per cent in 1998.

However, the economic crisis paved the way to transformation of the political regime from an authoritarian era to a democratizing one, marked by the 1999 democratic election. Not too long after that, in 2001, a decentralization process started with transferring most of government authorities and functions to the local governments. It has been a fundamental change from a strong centralized government to autonomous local governments accompanied with a series of elections at different administrative levels since 2005. Therefore, any assessment on poverty issues in Indonesia should consider the changing political landscapes, particularly during the democratizing era.

Indonesia immediately recovered from the Asian crisis when its economy grew at 0.8 per cent in 1999. Since then, the economic growth had been steadily increasing to reach its peak of 6.3 per cent in 2007. The first effects of the 2008–09 recession were felt in 2008, resulting in an economic growth rate of 6.1 per cent. The impact was larger in 2009, though the growth rate remained relatively high, at 4.5 per cent. Indonesia was one of the few countries in the world to be little affected by the global great recession.

As an effort to reduce the impact of the global great recession, in early 2009 the Government of Indonesia planned a fiscal stimulus package to maintain private consumption levels, as domestic consumption has contributed more

than 60 per cent of the country's GDP. Unemployment and poverty reduction may be affected, but they were not expected to be as severely as in 1997/98, as policies to keep inflationary pressures down were being launched.

In this chapter, we focus on the poor in democratizing Indonesia after the reform started in 1998. As described in Komite Penanggulangan Kemiskinan (2005), democratization, including regional autonomy, and globalization have resulted in the declining role of the government in poverty alleviation programmes. Participation from the general public and the poor themselves has become increasingly important — a striking contrast to the strong role of the central government before the reform. We expect that a better understanding of the poor will contribute to more effective and relevant policies in eradicating poverty and helping the poor to cope with any crisis at the national, regional, or global levels.

Furthermore, politics in the democratizing era may have created much tougher challenges for the government to implement their economic programmes, including those related to poverty, compared to during the authoritarian era.

In the next section, we discuss various concepts and measurements of poverty, particularly those used by Badan Pusat Statistik (Indonesian Central Bureau of Statistics). These concepts and measurements are also used in most of the statistics in this chapter. We then examine the trend of poverty in Indonesia. Next we discuss socio-economic characteristics of the poor, based on household data, where a household is defined to be poor if the average consumption of its members is below the national poverty line. We investigate household size, age, gender, education, household environment, and employment patterns of the head of household by the poverty status of the household. Finally, we evaluate some important government policies in alleviating poverty, particularly the social safety net programmes, a new feature during democratizing Indonesia.

CONCEPTS AND MEASUREMENT OF POVERTY

Indonesia in the democratizing era utilizes a rights-based approach to solve poverty. With this approach, poverty is not only concerned with income and consumption, but also the vulnerabilities to fall into poverty. Poverty involves deprivation of basic human rights necessary to maintain and enhance decent living, including those pertaining to the fulfilment of needs in food, health, education, jobs, housing, clean air, land, natural resources and the environment, feeling save from violent threats, and participation in social, economic, and political life, regardless of gender. The poor have equal rights to those of the non-poor (Komite Penanggulangan Kemiskinan 2005).

Sen (2000) considered poverty as the deprivation of basic capabilities, rather than having only low income. Deprivation of capability can be indicated by such things as premature mortality, undernourishment (particularly among children), persistent morbidity, illiteracy, and other failures. However, he did not deny the importance of the use of low income to measure poverty because he also agreed that a lack of income was one of the important determinants of a lack of basic capabilities to improve the quality of life. Lack of income can lead to the deprivation of a person's capability. He suggested starting the study of poverty from whatever information is available on poverty, including an assessment of people's income levels, though the study on poverty should not be limited to those under the poverty line as measured by consumption/income.

From a narrow economic point of view, as discussed in Tisdell (2007), poverty is a situation of extreme or severe scarcity of goods and services, resulting in individuals having great difficulty in meeting their basic needs for survival. There are two types of poverty. First are the people who have almost nothing to support their physical survival. Currently, there are still millions of people experiencing this absolute poverty in the world. Second are the people who do not have sufficient economic means to produce a minimum social standard of living. The line of this poverty is usually higher in richer countries. This is the so-called relative poverty.

Furthermore, globalization, world economic integration, and convergence, may have resulted in a new phenomenon of "global consumers, local earners", where on one hand individuals become global consumers with similar goods and services to be consumed at converging "world" prices; and, on the other hand, the individuals remain local earners as their wages are not allowed to converge to global wages. This happens when there is free flow of goods, capital, and highly skilled labour, but restricted movement of low-skilled labour. Thus, poverty is exposed to external shocks.

In this regard, some individuals may be far above the poverty line, particularly if measured by a country-specific poverty line, but they feel poor because their "reference population" is the world market, with global consumption, rather then the society where they physically live. That is what Sen (1981) called "relative deprivation", closely related to what individuals expect as well as what they view as fair and who should have the right to enjoy what goods and services.

Sen (2007) observed that historically, real term inter-country income inequality had increased in the last four centuries. Furthermore, the increase had been rising rapidly because of globalization in the last two decades. The feeling of economic deprivation among the non-poor officially, amid the world of growing affluence and conspicuous consumption, should be carefully

monitored. The size of this group may not be large, but the members of it are strong trendsetters and have important political voices. Unhappiness among members of this group may result in social tension. Therefore, Sen argued that the international poverty line becomes more relevant and meaningful than a country-specific poverty line in a globalized world.

Kakwani (2007) argued that the World Bank was the first institution that attempted to measure an international poverty line, reported in its *World Development Report 1990 Poverty* (World Bank 1990). The report used US$1 per day, measured in 1985 purchasing power parity (PPP), as the international poverty line. The line was constructed by assuming that it was the most common poverty line across low-income countries with available data on their country-specific poverty lines. Anybody under the US$1 level was said to be poor internationally. A new international poverty line was later introduced by the World Bank, which was US$1.08 and based on 1993 prices. It was the median of country-specific poverty lines in ten countries, including Indonesia. However, the World Bank continued referring to the new line as the US$1 poverty line. Kakwani, therefore, argued that the new poverty line should have been US$1.50 (at 1993 prices) if it had to be equivalent to US$1 at 1985 prices.

Furthermore, Kakwani argued that in-depth analysis of country-specific poverty is more relevant in understanding country-specific poverty and its policymaking in reducing poverty. The World Bank (2006) showed that the poverty rate, measured by the US$1 per day measure, in Indonesia was relatively very low, only 7.4 per cent in 2006. This is the rate of extreme poverty. Measured with US$2, however, 49 per cent of the population can be considered poor. Those between the US$1 and US$2 lines can be called moderately poor, and they constitute 41.6 per cent of the total Indonesian population. These moderately poor people can very easily fall into poverty, measured by US$1. In 2006, the PPP of US$1 was Rp97,218 per person per month and US$2 was Rp194,439 per person per month. This vulnerability may also result in a "bad coping mechanism", which may harm their human capital and make them harder to shift out of the poverty trap. In the meantime, the national poverty line in 2006 was set at US$1.55 per day.

To measure absolute poverty, Tisdell mentioned one measurement, the minimum consumption of 2,100 calories a day, recommended by the Food and Agricultural Organization (FAO). It is a physical subsistence measure of poverty. Those who cannot reach this level have a high probability of having a short life or suffering from malnutrition.

The above simple measurement of poverty is often called the "head count ratio", showing the percentage of the poor among the total population.

It is crude, and the most popular measure of poverty, indicating the incidence of poverty. This is a crude measure because it assumes that everybody under the poverty line suffers the same extent of deprivation. It does not measure the distance between the average consumption of the poor and the poverty line. Yet, those who are in the bottom, far below the poverty line, may suffer the most. The head count ratio may remain the same even if some of the poor become poorer.

The head-count ratio does not show the extent of inequality among the poor themselves. The same head count ratios may have different degrees of poverty depending on the extent of inequality among the poor. Not only does rising inequality result in jealousy, as Sen (1981) argued, it also drives prices of goods and services up and, therefore, deprives the less fortunate from consuming those goods and services. Therefore, measurement of an individual's poverty cannot be independent from the poverty of others.

To manage these issues simultaneously, Foster, Greer, and Thorbecke (1984) suggested a general formula to measure poverty:

$$P_{\alpha} = (1/n) \times \sum_{i=1}^{q} [(Z - X_i)/Z]^{\alpha} \qquad \text{Equation 1}$$

where n refers to the number of individuals in the population, i refers the ith individual, X_i refers to the consumption of individual i, Z refers to the poverty line, q refers to the number of the poor, α refers to a measure of poverty aversion (a larger α implies a heavier weight to the poorest poor).

When α is equal to zero, the equation represents the head-count ratio, or poverty rate, indicating the percentage of the poor population in the population.

$$P_0 = H = (1/n) \times q = q/n \qquad \text{Equation 2}$$

To measure the extent of the gap of consumption from the poverty line, α in Equation 1 is fixed to 1. Therefore, the formula becomes:

$$P_1 = (1/n) \times \sum_{i=1}^{q} \{(Z - X_i)/Z\} \qquad \text{Equation 3}$$

P_1 is an income-gap measure, indicating the average gap between consumption of the poor and the poverty line. It is also called the index of the depth of poverty. The larger the depth of poverty, the worse the gap and the greater the number of poor far below the poverty line.

To provide a measure of inequality among the poor, α is fixed to 2. The formula becomes:

$$P_2 = (1/n) \times \sum_{i=1}^{q} \{(Z - X_i)/Z\}^2 \qquad \text{Equation 4}$$

This inequality measure is often known as an index of the severity of poverty. The higher the index, the worse is the severity of the poverty.

Badan Pusat Statistik (BPS), the Indonesian agency which collects statistical data, applies the Foster, Greer, and Thorbecke formula. It uses the approach of the Food and Agriculture Organization (FAO) to define the absolute poverty line, which is generally an estimate of minimum consumption needs including food and other needs. The food poverty line identifies a basket of minimum essential food items, that is the expenditure on 52 food commodities needed to produce 2,100 calories per day per person. The non-food poverty line includes expenditures for 51 non-food items such as housing, clothing, health, education, and transportation in urban areas and 47 non-food items in rural areas. The total poverty line is the sum of the food poverty and non-food poverty lines.

As seen in Table 7.1, the poverty line in Indonesia has been estimated every year and differentiated between rural and urban areas. BPS first calculates the temporary poverty line in year *t*, by inflating the *t*–1 poverty line with the inflation rate in (*t*–1). Then it makes a "reference population", defined to include those 20 per cent above the temporary poverty line. From the reference population, it calculates the food expenditure needed to produce the 2,100 calorie requirement. This is the food poverty line. A similar technique is used to calculate the non-food poverty line.

With this poverty line, an individual with expenditures less than the poverty line is defined as poor. A poor household is one where the average per capita expenditure of its members is lower than the poverty line. A caveat in using these statistics is that this measurement has not considered changes in age-gender composition, though Indonesia has experienced rapid demographic changes.

It should be noted that BPS also attempted to measure non-consumption poverty. For example, in its 2000 publication, it calculated a score to indicate poor households using eight dummy variables as follows: per capita floor area, type of floor, source of drinking water, type of toilet, asset ownership, monthly income, the percentage of food expenditure, and consumption of meat, eggs, chicken, fish. The score is the sum of each of the eight variables. If the score is greater than or equal to 5, then the household is considered a

TABLE 7.1
Types of Absolute Poverty Lines by Urban-Rural Residence: Indonesia, 1996, 1999, 2007, 2008, and 2009

Residence/Year	*Types of Absolute Poverty Lines (per person per month, rupiah)*		
	Food	*Non food*	*Total*
Urban			
Feb 1996	30,455	11,577	42,032
Feb 1999	70,959	21,450	92,409
March 2007	132,259	55,683	187,942
March 2008	143,897	60,999	204,896
March 2009	155,909	66,214	222,123
Rural			
Feb 1996	23,844	7,522	31,336
Feb 1999	59,822	14,450	74,272
March 2007	116,265	30,572	146,837
March 2008	127,207	34,624	161,831
March 2009	139,331	40,503	179,835
Total			
Feb 1996	n.a	n.a	n.a
Feb 1999	n.a	n.a	n.a
March 2007	123,993	42,704	166,697
March 2008	135,270	47,366	182,636
March 2009	147,339	52,923	200,262

Note: US$1 was about 1,500 rupiah in 1996; 10,000 rupiah in 1999; and about 9,000 rupiah in 2007.
Source: Compiled from Badan Pusat Statistik (n.d.) and Badan Pusat Statistik (2007) Table 4.2a, and Badan Pusat Statistik (2009).

poor household. BPS also did similar studies at the provincial level for the province of South Kalimantan in 1999, Jakarta in 2000, and East Java in 2001, in each case using a different set of variables to measure non-income poverty (Badan Pusat Statistik 2007).

To assess the poverty alleviation programme, BPS has continued to make changes in the measurement of household poverty. Based on data from the 2005 SUSENAS (National Social Economic Survey), they used more variables, 14 variables, to identify whether a household was poor. The 14 variables are floor area, types of floor, type of wall, toilet facility, source of drinking water, source of light, source of household fuel, frequency

of eating in a day, habit of buying meat/milk, ability to buy clothes, ability to go to clinics, employment sector of the head of the household, education of the head of the household, and asset ownership. To calculate the score, BPS used the number of variables and gave a weight to each variable by district. The results of this survey were used to define the eligibility in the "rice for the poor" programme, examined later in this chapter.

In the meantime, Badan Koordinasi Keluarga Berencana Nasional — National Family Planning Coordination Board (BKKBN) — defined poor households as those who cannot satisfy even one of the following five conditions: members of the household carrying out their religious rituals; members mostly eating at least twice a day; members having different clothes for being at home, working, or travelling; having non-soil as the dominant part of the house; and participating in modern family planning for reproductive couples and receiving visiting health providers for sick children. In other words, a household is not considered to be poor if it can fulfil at least one of the five criteria (Badan Pusat Statistik 2007). This definition was used in implementing the social safety net programme for the health sector, discussed later in this chapter.

This chapter focuses on consumption poverty as defined by Badan Pusat Statistik. The discussion on these trends uses the individual as the unit of analysis, while that related to socio-economic issues as well as recipients of social safety net programmes utilizes the household as the unit of analysis.

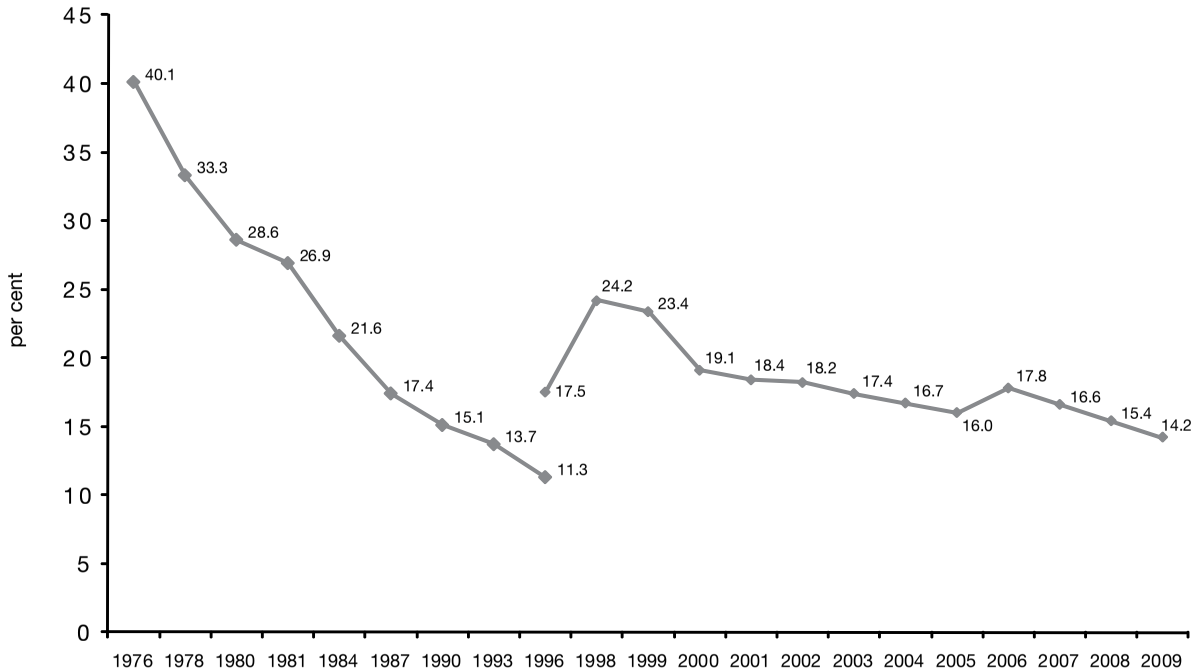
TREND OF POVERTY

Poverty alleviation has always been on the agenda of the government of Indonesia. Several policies and programmes for the poor have been implemented and government attention to poverty alleviation has been more serious in reaction to the severe impact of the Asian fiancial crisis. During the span of more than thirty years (1976–2007), as shown in Figure 7.1, Indonesia had managed to significantly reduce the poverty rate, although the 1997–98 Asian financial crisis disrupted the positive trend. The Asian financial crisis catapulted the poverty rate up to 24.2 per cent in 1998, before resuming the declining trend. It reached 14.2 per cent in 2009.

The declining trend of the poverty rate was also interrupted in 2006, rising to 17.8 per cent in 2006 from 16 per cent in 2005. The increase was a result of the heavy cut in fuel subsidies implemented by the government in late 2005, pushing the inflation rate to 17.11 per cent in 2005.

The declining trend of poverty resumed in 2007, though the rate was still larger than in 2005. Even the global 2008–09 recession did not stop the

FIGURE 7.1
Trend in Poverty Rate: Indonesia, 1976–2009



Note: There was a new method of measuring poverty in 1996. The figure for 2008 and 2009 refers to March.
Source: World Bank (2006) for 1976–1996, Badan Pusat Statistik (2007) for 1996–2007, Badan Pusat Statistik (2009) for 2008 and 2009.

declining trend. The poverty rate continued to decline and reached 14.2 per cent in 2009.

This is probably because of better preparedness to manage the crisis. In addition, the government has designed a fiscal stimulus package of 2.5 per cent of the 2009 GDP. The government efforts to ease the pressure on the people's purchasing power have benefited the lower levels of Indonesian society.

The absolute number of the poor has also followed a declining trend, from 49.5 million in 1998 to 32.5 million in 2009. However, as indicated in Table 7.2, because of the continuous increase in the total Indonesian population, the absolute number of the poor in 2008 was still larger than in 1996. It was only in 2009 that the absolute number of poor became less than in 1996. The global recession did not stop the declining trend of the absolute number of the poor.

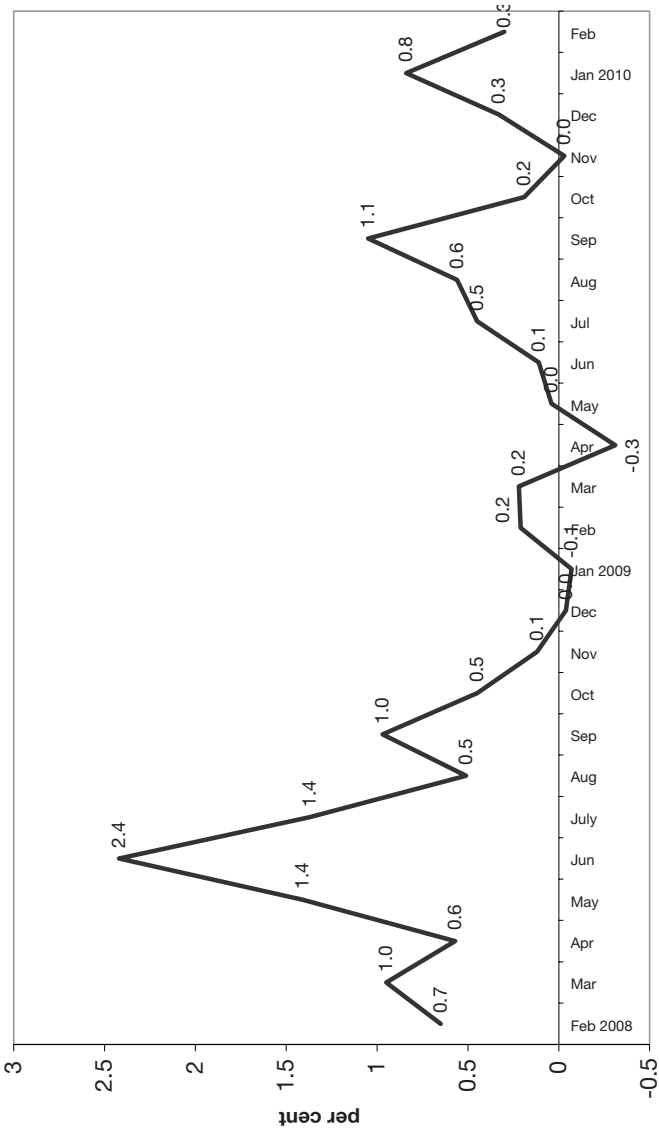
One of the reasons for the continued decline in both the absolute number of the poor and the poverty rate during the great recession was the relatively very low monthly inflation rate, especially during November 2008 until March 2009, as shown in Figure 7.2. It is interesting to note that the

TABLE 7.2
Trends in Poverty Rate and Number of the Poor in Indonesia, 1996 to 2009

Year	*Poverty Rate (per cent)*			*Number of the Poor (million)*		
	Urban	*Rural*	*Total*	*Urban*	*Rural*	*Total*
1996	13.4	19.8	17.5	9.42	24.50	34.01
1998	21.9	25.7	24.2	17.60	31.90	49.50
1999	19.4	26.0	23.4	15.64	32.33	47.97
2000	14.6	22.4	19.1	12.30	26.40	38.70
2001	9.8	24.8	18.4	8.60	29.30	37.90
2002	14.5	21.1	18.2	13.30	25.10	38.40
2003	13.6	20.2	17.4	12.20	25.10	37.30
2004	12.1	20.1	16.7	11.40	24.80	36.10
2005	11.7	20.0	16.0	12.40	22.70	35.10
2006	13.5	21.8	17.8	14.49	24.81	39.30
2007	12.5	20.4	16.6	13.56	23.61	37.17
2008	11.7	18.9	15.4	12.77	22.19	34.96
2009	10.7	17.4	14.2	11.91	20.62	32.53

Source: Compiled from Badan Pusat Statistik (2007) for 1996–2007 and Badan Pusat Statistik (2009) for 2008 and 2009.

FIGURE 7.2
Monthly Inflation Rate: Indonesia, February 2008 to February 2009



Source: Bank Indonesia.

great recession may have contributed to the reduction in poverty through a declining aggregate demand and, therefore, a declining inflation rate.

Nevertheless, the number of the poor in Indonesia is very large. The figure stood at 32.5 million in 2009, nearly seven times the total population of Singapore, the richest country in Southeast Asia. Therefore, the key features of poverty in Indonesia are its large absolute number and still relatively high percentage of the poor, compared to its neighbouring countries.

As illustrated in Table 7.2, the percentage and absolute numbers of the poor are higher in rural than urban areas, with the gap in the number of poor people between these two areas narrowing for the latest figure.

Table 7.3 shows that progress has also been made on the depth and severity of poverty. The indices declined after the crisis. The mean expenditure of the poor has been closer to the poverty line, implying that the poor have improved their situation, coming closer to the point of leaving poverty status. The index of poverty depth in the post-Suharto era reached its peak of 4.3 in 1999, since then the poverty alleviation programmes have successfully improved the poverty rate as well as the depth of poverty, with the index getting

TABLE 7.3
Indices of Depth and Severity of Poverty and Gini Ratio: Indonesia, 1996, 1999, 2007, 2008, and 2009

	Urban	*Rural*	*Total*
Depth of Poverty			
1996	n.a	n.a	3.10
1999	3.52	4.84	4.33
2007	2.15	3.78	2.99
2008	2.07	3.42	2.77
2009	1.91	3.05	2.50
Severity of Poverty			
1996	n.a	n.a	0.90
1999	0.98	1.39	1.23
2007	0.57	1.09	0.84
2008	0.56	0.95	0.76
2009	0.52	0.82	0.68
Gini Ratio			
1996	0.362	0.274	0.356
1999	0.350	0.276	0.357
2007	0.374	0.302	0.376

Source: Compiled from Badan Pusat Statistik (2007 and 2009), while the depth and severity of poverty (1996) are cited from World Bank (2006) Table 3.11.

smaller. Until March 2009 the index of poverty depth had been decreasing, reflecting more poor people coming closer to the poverty line. In addition, inequality among the poor has also been declining (shown by the severity index), indicating that crowding out of goods and services by the "better-off" among the poor has also declined and, therefore, reduced the burden of the poorest of the poor. Timmer (2004) argued that the Indonesian poor had always benefited from economic growth. Even during 1999, when per capita income declined by 0.4 per cent, the income of the lowest quintile dropped by only 0.3 per cent. The percentage decline seems small, but it might be significant for the poor. During 1967–2002, both per capita income and the lowest quintile recorded an annual growth rate of 4.15 per cent.

Sumarto and Widyanti (2008) found that there have been improvements in non-consumption poverty, such as the infant mortality rate and enrolment rates (particularly, elementary education). Improvements in educational levels can be seen from a decline in the percentage of people with less than primary education from 73.5 per cent in 1971 to 33.9 per cent in 2000 and 29.4 per cent in 2004.[1] The infant mortality rate declined from around 145 per 1,000 live births by the end of the 1960s to around 47 by the end of the 1990s and further declined to around 32 by 2005.[2] However, their figures also showed that Indonesians have not been successful in other areas of health, such as maternal mortality, undernourishment of children under five, and births helped by skilled attendants. About 25 per cent of children under five years old were malnourished, about 28 per cent of births were not accompanied by skilled birth attendants, about 45 per cent of poor households did not have access to sanitation, more than 50 per cent did not have access to safe water, and about 20 per cent of children from poor households had at most elementary school education. Therefore, they concluded, in Indonesia, non-consumption poverty was a more serious issue than consumption poverty.

Moreover, the overall inequality (for the whole population) has been increasing as shown by the rising Gini coefficient in both urban and rural areas, with urban areas always having higher inequality. It should be noted that the Gini coefficient of around 0.38 in 2007 was relatively very low, and most countries in the world have also experienced an increase in their Gini coefficients. It is similar to the level in the Netherlands, a country with a generous social welfare system, and much lower than in developing countries such as Brazil (0.61) and even Malaysia (0.49). Anecdotal observation seen in Jakarta may hint that the Gini coefficient might be underestimated, because the surveys failed to interview those in the very highest income groups (World Bank 2006).

The contribution to total income by the lowest 40 per cent of the population had also shown a sign of improvement. As described in Table 7.4, during 1996–2006, the contribution of this group to total income in both urban and rural areas showed a slight increase, for example, from 19.03 per cent in 1996 to 19.79 per cent in 2006 for urban areas.

TABLE 7.4
Distribution of Population Expenditure by Urban-Rural Residence: Indonesia, 1996, 1999, and 2006

Residence	*1996*	*1999*	*2006*
Urban			
Lowest 40%	19.03	20.52	19.79
Middle 40%	36.93	37.74	36.90
Highest 20%	44.04	41.74	43.33
Rural			
Lowest 40%	23.18	24.59	23.42
Middle 40%	38.99	39.53	39.04
Highest 20%	37.83	35.88	37.53
Urban and Rural			
Lowest 40%	20.25	21.50	21.42
Middle 40%	35.05	37.35	37.65
Highest 20%	44.70	41.15	41.26

Source: Compiled from Badan Pusat Statistik (2007).

As Indonesia is a very large country divided into 33 provinces in 2008,[3] with a large variation in their economies, it is expected that the poverty rate varies greatly across geographical and administrative areas. Measured by the poverty rate, depth, and severity of poverty, the provinces of Jakarta, Bali, and South Kalimantan have always been in the best five provinces. On the other hand, Papua (or West Papua and Papua) and Maluku, both in Eastern Indonesia, are always behind. In terms of absolute numbers, however, provinces on the Island of Java had a higher number of the poor simply because the provinces have much larger populations. See Tables 7.5, 7.6, and 7.7.

In a nutshell, the poverty rate measured from a number of indicators in Indonesia has declined, though is still accompanied with significant regional variation.

TABLE 7.5
The Five Poorest and Richest Provinces Measured by Poverty Rate: Indonesia, 1996, 1999, 2007

1996			*1999*			*2007*		
Province	*%*	*# ('000)*	*Province*	*%*	*# ('000)*	*Province*	*%*	*# ('000)*
The Richest Provinces								
Jakarta	2.35	215.8	Jakarta	3.99	379.6	Jakarta	4.61	405.7
Bali	7.81	227.0	Bali	8.53	257.8	Bali	6.63	229.1
South Kalimantan	8.53	247.5	West Sumatra	13.24	601.5	South Kalimantan	7.01	233.5
East Kalimantan	9.73	227.7	Riau	14.00	589.7	Banten	9.07	886.2
West Sumatra	9.84	426.2	South Kalimantan	14.37	440.2	Central Kalimantan	9.38	210.3
The Poorest Provinces								
Maluku	44.57	934.7	Irian Jaya	54.75	1,148.7	Papua	40.78	793.4
Irian Jaya	42.26	830.3	East Nusa Tenggara	46.73	1,779.0	West Irian Jaya	39.31	266.8
East Nusa Tenggara	38.89	1,395.1	Maluku	46.14	1,013.9	Maluku	31.14	404.7
						North Maluku	11.97	109.9
West Nusa Tenggara	31.97	1,169.3	West Nusa Tenggara	32.96	1,276.8	East Nusa Tenggara	27.51	1,163.6
Southeast Sulawesi	29.23	466.4	Southeast Sulawesi	29.51	504.9	Gorontalo	27.35	241.9

Note: Province of Irian Jaya was renamed as Papua in 2000, and split into Papua and and West Irian Jaya in 2003. Later in 2007, West Irian Jaya was renamed as West Papua. Province of Maluku was split into Maluku and North Maluku in 2000.
Source: 1996 and 1999 were compiled from Badan Pusat Statistik (n.d.) Table 3.3, 2007 were compiled from Badan Pusat Statistik (2007) Table 4.13.

TABLE 7.6
The Five Provinces with the Smallest and Largest Depth of Poverty: Indonesia, 1999 and 2007

1999		*2007*	
Province	*Index*	*Province*	*Index*
The Smallest			
Jakarta	0.58	Jakarta	0.59
Bali	1.30	South Kalimantan	0.81
South Kalimantan	2.08	Bali	0.94
Nanggroe Aceh Darussalam	2.16	Banten	1.40
Riau	2.28	Bangka Belitung	1.68
The Largest			
Papua	18.92	West Papua	12.97
Maluku	10.74	Papua	10.84
East Nusa Tenggara	10.57	Maluku	6.38
West Nusa Tenggara	6.23	Gorontalo	5.57
Central Sulawesi	6.21	Nanggroe Aceh Darussalam	5.41

Source: Statistics for 2007 were compiled from Badan Pusat Statistik (2008) Table 1.4.c. Statistics for 1999 were compiled from Badan Pusat Statistik (2002) Table 1.5.

TABLE 7.7
The Five Provinces with the Smallest and Largest Severity of Poverty: Indonesia, 1999 and 2007

1999		*2007*	
Province	*Index*	*Province*	*Index*
The Smallest			
Jakarta	0.14	Jakarta	0.12
Bali	0.31	South Kalimantan	0.16
West Kalimantan	0.37	Bali	0.23
South Kalimantan	0.46	Banten	0.34
Nanggroe Aceh Darussalam	0.50	West Sumatra	0.44
The Largest			
Papua	8.91	West Papua	5.66
Maluku	3.49	Papua	3.88
East Nusa Tenggara	3.29	Maluku	1.84
Central Sulawesi	2.09	Nanggroe Aceh Darussalam	1.61
Southeast Sulawesi	1.87	Central Sulawesi	1.38

Source: Statistics for 2007 were compiled from Badan Pusat Statistik (2008) Table 1.4.c. Statistics for 1999 were compiled from Badan Pusat Statistik (2002) Table 1.5.

SOME SOCIO-ECONOMIC CHARACTERISTICS OF THE POOR

The use of the three measurements of poverty may mask a wide variety of features associated with poverty, such as characteristics of the household and members of the household. This section shows a relatively strong relation between poverty rates on the one hand and characteristics of the houses and members of the household on the other.

Household Characteristics

The discussion in this section is focused on non-consumption poverty of households. In particular it examines the characteristics of the house as an indicator of the wealth and welfare of both poor and non-poor households, as shown in Table 7.8. The table shows that regardless of whether the households are poor or not, they own houses. The percentage of owning houses is very high among the poor (87) and even larger than that among the non-poor (82.8 per cent). Therefore, ownership of houses may not indicate wealth. Indeed, those who rent/lease houses have smaller head count ratios than those who own houses. Does this indicate that renting or leasing a house is a new lifestyle? Further studies should be carried out on this issue.

Building a house with bricks is quite common, and building a house with other materials such as wood and bamboo is also still common, especially among poor households. Table 7.8 indicates that 45.5 per cent of the poor lived in a house with brick walls, one third of them were in houses with wooden walls, and one fourth in houses with bamboo walls. A higher percentage (67.7 per cent) of the non-poor live in houses with brick walls. The poverty rate is associated with the type of wall of the house, in which the head count index was the lowest among those living in brick houses than others.

As competition for land and the finite supply tend to increase the price of land, the non-poor households live in larger houses, measured by per capita area of the floor. However, assuming a potentially healthy house should provide at least eight square metres of floor area per person, BPS found that 70 per cent of the poor households already lived in a "healthy" house. Furthermore, Table 7.8 also hints at a positive correlation between poverty rates and per capita area of the floor. The poor accounted for 25.2 per cent of those living in small houses. This was in contrast to the same figure of only 10 per cent for those living in a bigger house.

The majority of the houses used concrete roof tiles, with a slightly higher percentage (70.56) among the poor households than among non-poor households (68.07). The non-poor were more likely to use zinc/asbestos

TABLE 7.8
Household Environment of the Poor and Non-Poor: Indonesia, 2007

	Composition (per cent)		*Head Count Index*
	Poor	*Non-Poor*	
Per capita Floor Area (m^2)			
<= 8	30.78	15.46	25.24
9–15	39.12	35.15	15.88
>=16	30.11	49.39	9.37
Types of Floor			
Soil	69.65	11.33	31.24
Non-soil	30.35	88.67	11.76
Types of Roof			
Concrete/*Genteng/Sirap*	70.56	68.07	14.96
Zinc/Asbestos	20.66	27.78	11.20
Leaves/*Rumbia*	5.58	2.97	24.16
Others	3.19	1.17	31.56
Types of Wall			
Brick	45.49	67.72	10.23
Wood	33.14	22.89	19.72
Bamboo	19.38	8.53	27.83
Others	1.99	0.87	28.10
Sources of Light			
Electricity	81.02	93.39	12.83
Petromax/Aladin	1.44	0.98	19.96
Lantern/torch	16.13	5.08	34.02
Others	1.41	0.55	30.13
Sources of Drinking Water			
Clean Water	48.65	63.53	11.50
Others	51.35	36.47	19.28
Ownership of Toilet			
Own toilet	40.91	65.03	9.64
Common toilet	10.86	13.30	12.17
Public toilet/no toilet	48.23	21.67	27.41
Ownership of the house			
Own	87.03	82.79	15.13
Rent/Lease	3.77	7.35	8.00
Others	9.20	9.86	13.67

Source: Compiled from Badan Pusat Statistik (2007) Table 4.21–4.28.

than the poor. The lowest poverty rate was found among those who used zinc/asbestos for their roofs, followed by those who used concrete. Furthermore, the poor mainly lived in a house with a soil floor while the non-poor mainly lived in a house with a non-soil floor. The head count index was higher for households with soil floors than for those with non-soil

floors. In other words, the poor were more likely to live in a house with unhealthy construction.

Characteristics of house infrastructure, such as availability of electricity, source of drinking water, and existence of a toilet, are also consistent with information related to the poverty level. A relatively large percentage of both poor and non-poor had electricity as their source of light, with 93.4 per cent among the non-poor and 81 per cent of the poor. The head count index was lower among households having electricity than those having other sources of light.

Availability of clean water is an important indicator for health of the household members and indicates the level of poverty of the household. However, less than half of the poor had access to clean water for drinking. The percentage with access to clean water was higher among the non-poor, but was only 65.03 per cent. The head count index shows that households with clean water are less likely to be regarded as poor — the head count index was 11.5 per cent for households with clean water and 19.3 per cent for households without.

Toilet ownership is another important health indicator which may relate to poverty. Three types of toilet ownership can be seen among Indonesian households: owning a toilet, using a common toilet, or no toilet at all in the house. Table 7.8 shows that about 40 per cent of the poor did not own toilets and almost half did not have any toilet in the house at all. It should be noted, however, that though the percentage of owning a toilet is higher among the non-poor households, the percentage remained relatively low, at only 65.03 per cent. The head count index shows that poverty is higher among those living in a house without a toilet than those that own a toilet.

In short, the non-poor households had several distinguishing features related to lower consumption poverty measured by the poverty rate.

Characteristics of Household Members

This section describes some key characteristics of the members of the households, such as household size, age, gender, education, and employment. The dynamics of these characteristics are also examined across a time period spanning before and after Indonesia became a democratic country. As shown in Table 7.9, poor households have larger family sizes than non-poor households, with both having declining trends during 1996–2007. The gap in household size between poor and non-poor households has been narrowing over the observed period with a relatively slower decline among the poor households during the first eight years of democratizing Indonesia. This may indicate the

impact of the decentralized government family planning programme since the implementation of regional autonomy in 2001.

The family planning programme had focused more on rural than urban areas as the poor tend to live in rural areas. The size of the non-poor households remains the same from 1999 to 2007, or with just a slight increase from 3.9 in 1999 to 4 in 2007. It is still not clear, however, whether in rural areas household size affects poverty or vice versa. Deeper studies should be done to examine the possible causality between household size and household poverty. Or, if a household is defined to be poor when its per capita expenditure is below the poverty line, then a larger household is more likely to have a lower consumption per capita of members of the household.

The gender of the head of household may be associated with the incidence of poverty as it is hypothesized that women-headed households are more vulnerable to poverty than those headed by men. However, as shown in Table 7.9, the percentage of female heads of households is lower among the poor than the non-poor, and the gap between these two groups rose from around 0.4 percentage points in 1996 to 1.7 percentage points in 2007, implying a faster increase in the women-headed non-poor households.

The age of the household's head may not seem to have an important association with being a poor household. Yet, Table 7.9 may provide a slight indication that the average age of the heads of poor households is increasing, particularly relative to the heads of non-poor households. One possible explanation is the occurrence of accelerating population ageing in rural areas, as mentioned in Ananta and Arifin (2009), where the fertility rate has been relatively low and, at the same time, many more young persons migrated out

TABLE 7.9
Socio-demographic Characteristics of Head of Households: Indonesia, 1996, 1999, and 2007

Characteristics	*1996*		*1999*		*2007*	
	Poor	*Non-poor*	*Poor*	*Non-poor*	*Poor*	*Non-poor*
Mean Household size	5.20	4.19	4.80	3.90	4.74	3.97
% Female head	11.97	12.38	12.23	13.62	12.58	14.28
Mean age	45.03	45.29	46.30	46.20	49.03	48.00
Mean years of schooling	3.67	6.30	4.00	6.30	4.41	7.05

Source: Badan Pusat Statistik (1999, 2007).

from the rural areas. As shown in Table 7.9, an increase in the mean age of the household's head is observed in both the poor and non-poor, reflecting the general trend of population ageing in Indonesia.

Rising education has often been expected to reduce poverty. Indeed, statistics in Table 7.9 do not reject the hypothesis. They show that the head of non-poor households had more mean years of schooling. The education of the head of the household also increased during the democratizing era, with a faster rise among the non-poor. In 2007, on average, the heads of the non-poor households had completed primary school education in contrast to those of poor households who on average had not (in Indonesia, students normally require six years to complete primary education). Furthermore, Badan Pusat Statistik (2007) also found that 20.46 per cent of household heads with less than primary education could be categorized as poor, in stark contrast to only 0.59 per cent among households headed by university graduates.

Employment is another key variable to understand the poor. Table 7.10 indicates that the poor households had a larger percentage working in agriculture, compared to the non-poor households, implying that agriculture may still be associated with poverty. Table 7.10 also shows that the highest poverty rate was seen among those who worked in agriculture, and the lowest in services.

Grouping employment by working status, Table 7.11 shows that the percentage of self-employed or those assisted by unpaid workers is larger among the poor than among the non-poor households. It also describes that the lowest poverty rate was found among those who worked as employers assisted by regular workers. The highest poverty rate was seen among the self-employed/assisted by unpaid workers (17.15 per cent), followed by unpaid workers (15 per cent).

TABLE 7.10
Employment Sector of the Poor and Non-poor: Indonesia, 2007

Employment sector	*Urban*		*Rural*		*Head Count Index*
	Poor	*Non-poor*	*Poor*	*Non-poor*	
Not working	15.51	16.41	11.21	9.95	14.20
Agriculture	27.64	11.94	69.98	54.06	21.71
Industry	7.68	11.37	4.65	6.06	10.17
Others	49.16	60.28	14.16	29.94	9.54
Total	100.00	100.00	100.00	100.00	16.60

Source: Compiled from Badan Pusat Statistik (2007) Table 4.19.

TABLE 7.11
Employment Status of the Poor and Non-poor: Indonesia, 2007

Employment status	*Urban*		*Rural*		*Head Count*
	Poor	*Non-poor*	*Poor*	*Non-poor*	
Not working	15.51	16.41	11.21	9.95	14.20
Self-employed/assisted by unpaid workers	46.83	34.29	62.95	58.96	17.15
Unpaid workers	0.61	0.89	1.40	1.20	15.00
Employers with regular workers	1.03	5.88	1.14	3.84	3.65
Regular Workers/Free workers	36.02	42.54	23.30	26.05	12.25
Total	100.00	100.00	100.00	100.00	16.60

Note: Formal sector includes those who work as employers with regular/paid employees or regular/paid employees.
Source: Compiled from Badan Pusat Statistik (2007) Table 4.19.

SOCIAL SAFETY NET PROGRAMMES

In a market-oriented economy, social safety nets have often been used to help those who cannot compete in the market, particularly those who are chronically poor — those who have been poor for a very long time. Dowling and Yap (2009), for example, argued that social safety nets are designed to solve the problems faced by those who suffer from persistent poverty and/or those who are going deeper into poverty. Social safety nets are not targeted at the transient or temporary poor. They mentioned five types of social safety nets: cash transfers, universal food subsidies, rationed food subsidies, public works, and social funds.

In Indonesia, as described in Sumarto and Widyanti (2008), as well as Hutagalung, Arif, and Suharyo (2009), the government has introduced several social safety net programmes (JPS, Jaringan Pengaman Sosial) to prevent chronically poor individuals from falling more deeply into poverty as well as to reduce the number of vulnerable individuals. The government acknowledged that general macroeconomic improvements are needed to help the poor, but more should be done to help the poor directly. The JPS did not exist before the 1997–1998 Asian financial crisis. People used to utilize their own private coping mechanisms during crises:

cutting expenditures, borrowing, relying on family members, and/or attempting to increase their incomes.

Sumarto and Widyanti also elaborated that in July 1998, with help from international donors such as the World Bank and Asian Development Bank, the government launched social safety nets for education, health, community empowerment, employment creation, and rice subsidy programmes. Those were aimed to prevent or significantly reduce the severity of the crisis. There are four programmes of the JPS: to ensure the availability of affordable food; to enhance household purchasing power by creating labour-intensive programmes; to create access to critical social services, mostly health and education; and to sustain local economic activities by providing regional block grants for public works and extending small-scale credit.

The subsidized rice programme (OPK, Operasi Pasar Khusus/Special Market Operation), initiated in July 1998, was very important as rice expenditure is a large component of total expenditures among the poor households. Sumarto and Widyanti mentioned that expenditure on rice constituted 34 per cent of the poverty line in rural areas, and 26 per cent in urban areas.

The government made a cosmetic change of OPK into RASKIN (*beras miskin*, rice for the poor) programmes in the middle of 2001, and this became the most expensive JPS programme until mid-2005. Since 2006, the programmes have focused on poor households as defined by Badan Pusat Statistik, using the 2005 Social Economic Survey data, discussed earlier in this chapter. In 2007, each targeted household could buy ten kilograms of rice at 1,000 rupiah per kilogram from a distribution point every month. The market price in Koperasi Pasar Induk Cipinang, Jakarta, was between 4,000 and 4,100 rupiah by the end of March 2007.[4]

However, the data in 2007 show that the lowest 30 per cent of households (the first three deciles) received less than 50 per cent of total expenditure of the rice for the poor programme. The rest went to higher expenditure groups. About 10 per cent of programme expenditures even went to the three highest expenditure groups, those who were clearly not supposed to receive rice for the poor support. Table 7.12 indicates that rural areas suffered from the worst targeted allocation. In rural areas, the three lowest deciles only bought 36 per cent of the "rice for the poor" available to rural areas; while the three lowest deciles in urban areas could buy about 55 per cent of the "rice for the poor" available to the urban areas.

Furthermore, Table 7.13 hints that in each expenditure decile the percentage of the recipients of the rice programme was higher in rural than urban areas. Even among the tenth (highest) decile the percentage of the

TABLE 7.12
Percentage Distribution of Recipients of "Rice for the Poor" by Expenditure Decile and Residence: Indonesia, 2007

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	21.78	12.33	16.32
2nd	19.47	12.24	15.34
3rd	14.34	11.89	14.30
4th	13.02	10.85	13.16
5th	10.47	10.91	11.90
6th	7.24	10.91	10.06
7th	5.06	9.70	8.11
8th	4.73	8.68	5.88
9th	2.63	6.92	3.49
10th	1.27	5.56	1.44
All households	100.0	100.0	100.0

Source: Compiled from Badan Pusat Statistik (2007).

TABLE 7.13
Recipients of "Rice for the Poor" Per Decile by Residence: Indonesia, 2007 (percentage)

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	76.94	74.09	77.38
2nd	68.86	73.61	72.78
3rd	50.63	71.52	67.83
4th	46.17	65.22	62.41
5th	37.01	65.56	56.42
6th	25.59	65.51	47.69
7th	17.84	58.33	38.48
8th	16.78	52.19	27.88
9th	9.31	41.60	16.57
10th	4.49	33.44	6.81
All households	35.37	60.11	47.74

Source: Compiled from Badan Pusat Statistik (2007).

recipients was larger in rural areas. One third of the tenth (highest) decile in rural areas could buy the "rice for the poor", in contrast to only 4.5 per cent in urban areas.

Another large element of the social safety net programme was the Padat Karya (labour intensive) employment creation programme, begun in late 1997 and funded mostly from the government budget. Sumarto and Widyanti showed that this programme reached not only the chronic poor group but

also the transitory poor group. They concluded that this programme had better results than those for education and health, discussed in the following paragraphs.

The JPS-BK (Jaringan Pengaman Sosial–Bidang Kesehatan, Social Safety Net for Health Sector) was created in anticipation of deteriorating health because of the 1997–1998 crisis. One of the activities entailed free health services for those who were considered poor according to the BKKBN criteria described earlier. In this programme the eligible households could obtain free medical services and medicine at public health clinics.

However, this programme might have spoilt the society (Sukamdi and Setiadi 2003). People enjoyed the cheap medical services during the crisis. When the crisis was over, the cheap services were no longer available, and they became frustrated. Therefore, there is a need to sustain the provision of cheap medical services, even though the crisis is over.

Our interview with two local health providers of a reputable hospital in Bandung, West Java, in the middle of 2007, revealed concern about the same issue. The providers' complaint was that because the services are free, the patients are more likely to demand as many kinds of services as possible. People asked for the maximum services because they did not have to spend anything. In other words, the free health-services scheme created an "excess demand" for the services which had overburdened the health providers. During the democratizing era, the patients really knew their rights to enjoy the free health services. As a consequence, they asked for things they would not have had they been required to pay. They had requested "unnecessary things and services".

As expected, shown in Table 7.14, the higher the expenditure decile, the higher is the percentage of non-recipients of free health services in 2007. The percentage of non-recipients of free health services was slightly higher in rural areas. Table 7.15 indicates that the programme of free health services for the poor did not really reach the target of the rural population indicated by the relatively low percentage of recipients in each decile. Only 23.3 per cent of the lowest decile in rural areas received these free services. Yet, the richest also enjoyed this service.

The social safety net on education was not successful either. As described in Dowling and Yap (2009), the government made block grants to schools to be used to finance the education of poor students. The schools were responsible to determine who would be eligible for the money from the block grants. Worse, the money was distributed to those who were already or still enrolled. Those who had dropped out or had not been able to enrol were not targeted. This resulted in limited effectiveness of the programme.

TABLE 7.14
Distribution of Those Who Did Not Receive Free Health Services by Expenditure Decile and Residence: Indonesia, 2007

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	8.55	9.26	9.07
2nd	8.70	9.69	9.19
3rd	9.50	9.30	9.43
4th	9.73	9.67	9.68
5th	9.58	9.88	9.85
6th	10.39	10.35	10.06
7th	10.58	10.08	10.09
8th	10.63	10.63	10.60
9th	11.23	10.43	10.81
10th	11.11	10.73	11.24
All households	100.0	100.0	100.0

Source: Compiled from Badan Pusat Statistik (2007).

TABLE 7.15
Recipients of Free Health Services per Decile by Residence: Indonesia, 2007

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	27.73	23.33	24.06
2nd	26.41	19.66	22.95
3rd	19.78	22.92	21.06
4th	17.44	19.90	18.98
5th	18.95	18.08	17.51
6th	12.09	14.30	15.77
7th	10.72	16.42	15.75
8th	9.83	11.89	11.06
9th	4.97	13.51	9.49
10th	5.89	11.09	5.83
All households	15.38	17.11	16.25

Note: The statistics for "total" should be between "urban" and "rural". There can be some miscalculations in Badan Pusat Statistik (2007) relating to the 5th, 6th, and 10th deciles. However, the mistakes may not be sufficiently significant to affect the conclusion.
Source: Compiled from Badan Pusat Statistik (2007), Tables 4.33b, 4.34b, and 4.35b.

The World Bank (2006) showed that the social safety net programme is the so-called "second generation" of this kind of programme. It is an improvement over the first generation of programme which emphasizes provision of general price subsidies, implemented by many developing countries during the 1960s

and 1970s. Yet, until 2005, Indonesia still provided a heavy fuel price subsidy, fixing the fuel price at much below the world price level. Indeed, it was still the crux of the social protection system until 2005. The Government of Indonesia believed that the domestic price of fuel should converge to the "world" price, though the income of most Indonesians is still below the "world" income.

In 2005, the Government of Indonesia believed that the fuel subsidy only benefited richer families that consume more fuel than the poorer ones do. The World Bank (2006) found that the benefit from the subsidy enjoyed by the richest 10 per cent of the population was more than five times that which went to the poorest 10 per cent of the population. It concluded that the amount given to subsidize the price of fuel should have been transferred directly to the poor and that the price of the fuel should converge to the "world" price.

Therefore, as elaborated by the World Bank (2006), with the rocketing world price of fuel, the Government of Indonesia made a brave decision to cut the fuel price subsidy twice, first in March 2005 and second in October 2005. To help the poor cope with the sudden rise in the price of fuel, the government provided fresh funds for education, health, and rural infrastructure after March 2005. Then, after October 2005, the government implemented a cash transfer programme, called a direct cash subsidy (Subsidi Langsung Tunai, SLT), anticipating that many would fall into poverty. This programme is also known as unconditional cash transfer (Bantuan Langsung Tunai, BLT), benefiting 19.2 million households in 2006. This is a temporary, one-year programme.

Sumarto and Widyanti described the BLT as an ambitious social protection programme. The programme provided a cash transfer of 100,000 rupiah per month per household, disbursed through post offices quarterly for one year. It targeted the poor. The eligibility was based on enumeration of households in 2005 socio-economic data collected by BPS, discussed earlier in this chapter.

Nevertheless, Table 7.16 hints that only about 50 per cent of the recipients came from the three lowest deciles of the population, the groups supposed to receive the transfer. On the other hand, more than 10 per cent of the help went to the three highest income groups, those not supposed to receive any such help. This indicates poorly executed allocation of the poverty programme. This deficiency was even worse in rural areas, where a smaller percentage of the money went to the three lowest deciles and a higher percentage went to the three highest deciles, relative to their urban counterparts. As shown in Table 7.17, 62.9 per cent of the richest decile received the cash transfer. The percentage of people in the first decile that

TABLE 7.16
Percentage Distribution of Recipients of BLT/SLT by Expenditure Decile and Residence: Indonesia, 2007

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	26.43	16.42	20.23
2nd	18.91	13.53	16.82
3rd	15.04	12.74	14.63
4th	12.30	11.71	12.67
5th	7.92	10.56	10.84
6th	6.36	9.54	8.15
7th	4.86	8.63	6.27
8th	3.26	6.53	5.13
9th	2.34	5.88	3.07
10th	2.58	4.46	2.21
All households	100.0	100.0	100.0

Source: Badan Pusat Statistik (2007).

TABLE 7.17
Recipients of BLT/SLT per Decile by Residence: Indonesia, 2007 (percentage)

Decile	*Urban*	*Rural*	*Urban and Rural*
1st	57.21	66.46	62.85
2nd	40.98	54.83	52.34
3rd	32.55	51.61	45.48
4th	26.72	47.39	39.37
5th	17.16	42.77	33.70
6th	13.78	38.63	25.33
7th	10.52	34.98	19.46
8th	7.09	26.45	15.97
9th	5.07	23.82	9.53
10th	5.60	18.07	6.86
All households	21.67	40.50	31.09

Source: Compiled from Badan Pusat Statistik (2007).

received the cash transfer is higher in rural areas (66.5 per cent) than in urban areas (57.2 per cent).

Another BLT programme[5] was launched in June 2008 to help the poor with another sudden increase in the fuel price, attributed to another cut of the subsidy in the same year following the skyrocketing world crude oil price to US$140 per barrel. However, this time the programme faced stronger critics in the run-up to the 2009 elections — critics suspected that the BLT was

used as one of several election goodies. Furthermore, with declining global oil prices during this period, the government *reduced* the price of fuel three times in 2008. The government then announced it would discontinue BLT after February 2009.[6] Yet, the last portion of this BLT (for the months of January and February) was disbursed from 18 March 2009.

The timing of the last disbursement may have been coincident with the campaign period for the parliamentary election conducted on 9 April 2009 and the presidential election on 6 July 2010. One of the parties contesting in the parliamentary election was Partai Demokrat (Democrat Party), the party of the incumbent President Susilo Yudhoyono. The President was also one of the presidential candidates for the presidential election. Nevertheless, Bachtiar Chamsyah, the then Minister of Social Affairs, who was distributing the cash transfer, said that the timing had nothing to do with the political campaign.[7]

Mis-targeting may be partly because of difficulty in administering the eligibility of recipients, as everyone wants to be registered as "poor". Therefore, some local governments have just distributed the money equally to all households. "Democracy" means that people can complain and sue the government officials who are suspected to have not distributed the money fairly. The problem of identification of the eligible households can result in conflict and even riots. Therefore, one of the solutions taken by those who implemented the programme was simply to distribute the money to every household in the village, regardless of their eligibility.

Unlike the BLT, which is temporary in nature and responding to a particular event, a new, longer, poverty programme was created by the Government of Indonesia in 2007. This is the so-called PKH (Program Keluarga Harapan, Hopeful Family Programme), planned to be the basis for the creation of the future social security system in Indonesia, particularly for the poor. The programme is planned to be implemented until 2015, to improve the quality of health and education of the children of approximately 6.5 million chronically poor families. This is a demand-side approach, which provides money for the health and education of the children of the poor. Therefore, the success of this programme also relies heavily on the supply side — the availability, access, and quality of existing health and educational services in the neighbourhood of the poor. The opportunity cost of going to school (if the children significantly contribute to the household income) will also influence the performance of the new programme (Hutagalung, Arif, and Suharyo 2009).

Dowling and Yap (2009) described this as a conditional cash transfer (CCT) programme to help the poor by requiring the commitment of the

families to improve the health (including nutrition) and education of their children. If the families fail to implement the health and education programme, the cash transfer will be stopped. In other words, it is created to enhance human capital of the younger generation of the poor so that they can escape from the intra-generational poverty trap, and become the hopeful of the future generation. This programme has been recognized by the international community and donors have provided support for it, though Bangladesh and Indonesia were still the only two countries using the scheme. The programme in Latin America is often carried out by the central government, with the objective of cutting the bureaucracy and reducing corruption.

In Indonesia, as mentioned in Sederlof (2008), Kharisma (2009), and Hutagalung, Arif and Suharyo (2009), the PKH provided cash transfers to every poor household[8] with the presence of conditions such as pregnant or lactating mothers and/or children under five and/or children of school age (6–18 years), satisfying certain conditions. The conditions are set to make sure that the beneficiaries receive at least the minimum services in health and education for mothers and children.[9] The chronically poor households receive a fixed transfer of Rp200,000 per year in addition to one of the following conditions. They receive Rp800,000 a year if the household has a pregnant/lactating woman, Rp800,000 a year for the presence of a child under six years old, Rp400,000 a year for the presence of a child of primary school age (7–12 years old), and Rp800,000 for the presence of a child of junior high school age (13–15 years old) or the presence of a child under 18 who has not completed primary school. The maximum amount a household can receive is Rp2.2 million, with a minimum of Rp600,000. The average amount is Rp1,390,000. If a PKH recipient fails to comply with the targeted conditions, the cash transfer will be terminated after a few warnings have been given.

This programme needs an accurate database for the selection of eligible households and updating the progress of these households, as well as strong coordination among many parties involved. The Ministry of Social Affairs is the implementing agency, especially UPPKH (Unit Pelaksana Program Keluarga Harapan, the PKH's programme offices at national and district levels), through post offices. The targeted households collect the funds quarterly from the post offices.

The programme was initially implemented in forty districts in seven provinces, namely West Sumatra, Jakarta, West Java, East Java, East Nusa Tenggara, Gorontalo, and North Sulawesi. In 2008 it was expanded to an additional six provinces: Aceh, North Sumatra, Banten, Yogyakarta, West Nusa Tenggara, and South Kalimantan. As mentioned by Sederlof (2008), one of

the criteria to choose the districts was the availability of health and educational facilities and therefore it solves the problem from the supply side.

Early evaluation shows that the programme has achieved its target. Syukri et al. (forthcoming), for example, analysed the data collected from February to May 2009 in two provinces implementing the programme: West Java and East Nusa Tenggara. From each province, two villages (one rural and one urban) were selected. They found that the PKH has improved the use of educational and health facilities as well as goods needed to improve the health and education of the children. However, they also found that many respondents also allocate the money to other things, such as improving the daily food consumption of the whole household, repairing the house, or buying livestock. They also showed that the field advisers were very important in helping the women making the decision on the allocation of the money. The poorer the household, the more likely it is to spend the money from the programme for other purposes.

CONCLUDING REMARKS

Economic policies are never made in the vacuum of social and political landscapes, particularly during democratizing Indonesia since 1998. Prior to the democratizing era, the government played a dominant role in poverty alleviation through developmental programmes. In contrast, civil society has also emerged taking on increasingly important roles in tackling poverty issues during the democratizing era. The governments have become more "populist", by creating an increasing number of social safety net programmes, including the "direct cash transfer" and "conditional cash transfer" for those defined to be poor.

Nevertheless, the implementation of the social safety net programmes has not been smooth. Leakage and mis-targeting may be the two biggest challenges the programmes face. Despite the challenges, gauged by the three measurements (head-count ratio, depth of poverty, and severity of poverty), consumption poverty has continued to decline in Indonesia, with rural poverty always higher than urban poverty. The rates were already lower compared to those before the 1997–1998 crisis, but the absolute number of the poor is still slightly larger than before the crisis, partly contributed by the growing Indonesian population. However, within the overall population, not only among the poor, income inequality is better within the rural than the urban population.

A more interesting observation is that the recent 2008–09 great recession did not seem to affect the declining trend of poverty in Indonesia. On the

other hand, perhaps the great recession had helped to further reduce poverty by reducing the aggregate demand and then inflation in Indonesia.

Among the provinces, the worst poverty is seen mostly in Eastern Indonesia, particularly in Papua, West Papua, and Maluku. The three best provinces in terms of the lowest poverty are Jakarta, Bali, and South Kalimantan.

Though this chapter focuses on consumption poverty, our examination of heads of households reveals that the statistics on head count ratio of consumption poverty are consistent with selected indicators of non-consumption poverty. We show that the statistics on the poverty rate has relatively strong associations with characteristics of the house and members of the households. Yet there remain a lot of challenges ahead. The more serious challenge is to reduce non-consumption poverty.

As concluded by Sumarto and Widyanti (2008), the government has improved the poverty alleviation initiatives by basing their programmes on rigorous and independent impact evaluation studies and increasing the budgets. Nevertheless, the poor remained vulnerable and there has been mixed success in achieving the Millennium Development Goals, especially as related to maternal health. Despite the success, poverty issues are still crucial for Indonesia. Continuous improvement in the programmes must be made to ensure no Indonesians suffer from chronic poverty.

It may be too early to conclude that the social safety net programmes have significantly contributed to the decline of poverty. Both the incidence and percentage of poverty already declined during the New Order era, when there was no social safety net programme. The recent great recession may even have helped the continuing declining trend of poverty in Indonesia.

At this juncture we may contemplate a fundamental issue; to what extent the kind of social safety net programmes, such as giving cash transfers, really help people out of poverty. When being defined as "poor" has become "desirable/profitable", will the social safety net programmes create a sociocultural dependency mentality or even begging mentality, as discussed in Sukamdi and Setiadi (2003)? Indeed, the rising percentage of "not working" among the poor may hint at the possible increase of this mentality. Furthermore, Hatmadji and Mursitama (2003) warned that the large amount of money for the programmes and the presence of "project mentality" among bureaucrats, who might not care that the money spent was from government loans, could have produced a vested interest in obtaining some of the money.

On the other hand, a qualitative study on two villages from each of five provinces (North Sumatra, West Java, Central Java, West Nusa Tenggara, and North Maluku) in 2008 showed no impact of the cash transfers on labour force participation and number of working hours. The labour force participation and number of working hours are mainly determined by the village labour

market. Most of the jobs in the villages are seasonal and therefore there is no motivation for them to skip working. Some are daily workers in plantations, where missing one work day may mean losing the job because someone else can immediately fill in the vacancy (Satriana n.d.). It is also possible that the workers knew that the transfer was only temporary and therefore not worth losing their jobs over. They may also feel that the amount of cash transfer is too small to induce them to skip their jobs. They still need more money to fulfil their daily needs.

A question can be raised over how much of the money should actually be spent for the poor, and how much for the implementation, including honorarium or salaries for the people who implement the projects. Which one is better; to give the money directly to the poor, or to build infrastructures that can pull them out of poverty? For example, to what extent should the money be spent on things such as building clean sanitation, mitigating floods and landslides or other natural disasters, creating freedom from fear, and providing information on labour markets and consumer awareness?

Finally, Indonesia has emerged as one of the few least vulnerable economies during the recent great recession. However, Indonesia must continue to be vigilant, in case another deeper global crisis occurs in the future. World population ageing, for example, may soon become a serious financial threat in many rich countries. If not well anticipated, population ageing may become the trigger of another global financial crisis through the rising government budget deficit.

Because pensions are very limited in Indonesia, the Government of Indonesia does not face the problem of a rising budget deficit as its population ages. Nevertheless, the current rapidly ageing population process in Indonesia will raise the number of poor older persons and, consequently, poverty rates with its huge social, economic, and political implications.

Notes

1. Calculated from Badan Pusat Statistik (2005), Table 2.4.3.
2. The statistics on life expectancy at birth is not shown here because the information overlaps with that on IMR. Life expectancy at birth is calculated based on adult mortality data. However, Indonesia does not have accurate information on adult mortality. So far the statistics on adult mortality are estimated using a life table model, with the data on IMR and child mortality as the only empirical statistics. Therefore, knowledge on life expectancy at birth must be similar to that on infant mortality.
3. The number may keep growing as there are more demands to split some provinces.
4. "Pemerintah Tak Bisa Cegah Kenaikan Harga Beras", *TEMPO Interaktif*, 1 April

2007. In 2008 the price of Raskin rose to 1,600 because of the rising market price.

5. The BLT programme earmarking Rp41.1 trillion was launched by the government in June 2008 when fuel oil prices were raised due to the skyrocketing of the world crude oil price to US$140 per barrel. Around 19 million poor families throughout Indonesia were recorded to have received a cash assistance of Rp100,000 each plus cooking oil and sugar packages per month in compensation for the increased price of goods following the government's decision to raise domestic fuel prices. The last portion of the assistance disbursed on 18 March 2009 was the continuation of BLT phase I (three months) and phase II (four months) provided in 2008. After the government lowered the subsidized fuel prices three times in 2008, the House of Representatives approved only to extend the BLT programme until January–February 2009. It other words, the programme lasted for nine months.
6. "Govt to Disburse Last Portion of Direct Cash Assistance", *Jakarta Post*, 11 March 2009.
7. "$310 Million Mailed to the Poor", *Jakarta Globe*, 18 March 2009.
8. The beneficiaries of the PKH must be chronically poor persons, far below the poverty line. The government uses 14 criteria to determine who the chronically poor are. To be eligible for the programme, a household must fulfil at least 13 of the 14 criteria.
9. The indicators that must be met by the programme beneficiaries are as follows. For the health sector, the pregnant or lactating mothers must have four antenatal care visits and have iron tablets during pregnancy, births attended by a trained health professional, and two post-natal care visits for lactating mothers. The 0–6 year old children must have childhood immunization (BCG, DPT, polio, measles, Hepatitis B, and additional immunization), take vitamin A capsules twice a year, have monthly growth monitoring for infants and quarterly monitoring for those 1–6 years old. All primary and junior high school age children must be enrolled with a minimum of 85 per cent school-day attendance.

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8

THE POLITICAL ECONOMY OF RICE AND FUEL PRICING IN INDONESIA

Arianto A. Patunru and M. Chatib Basri[1]

The years of the 1980s witnessed a declining trend of trade protection in many countries in the world. In Indonesia, trade protection levels were relatively high from the 1970s up to the mid-1980s, before a substantial reduction as a result of various trade reforms. Despite a slow progress of trade reform in the 1990s, Indonesia has become a relatively open economy and deserves much credit for its unilateral liberalization. The trade regime became more open when the International Monetary Fund (IMF) entered following various unsuccessful attempts by the Indonesian Government to stabilize the rupiah. Unlike in Thailand and in other countries, IMF packages in Indonesia included trade reform which was normally beyond the mandate of the Fund. As discussed in Soesastro and Basri (2005), the structural adjustment programme encouraged a gradual reduction of import tariffs. In addition, as part of the structural reform programme of 15 January 1998, domestic trade in agricultural products, including rice, was fully deregulated. The clove marketing board owned by President Soeharto's son was eliminated. In February 1998 all other marketing arrangements were terminated, specifically those of cement and paper, while plywood cartels were dissolved. Formal and informal barriers to investment in palm oil plantations were removed, followed by the removal of all investment restrictions in wholesale and retail trades. Proposals for trade deregulation

commonly associated with the World Bank had been captured in these IMF packages. The trade reform programme was obviously significant and has removed most of the non-tariff barriers.

Indonesia has been making efforts to increase efficiency by removing restrictions on trade, investment, and production, and streamlining procedures at the border. As a consequence it has been able to cut tariffs to an average of below 10 per cent. In general the Indonesian average tariff is relatively low compared to some Asian countries and to Mexico, Poland, Brazil, and Turkey. Furthermore, the implementation of the tariff reduction programme has reduced the unweighted average applied tariff rate from 15.5 per cent in 1995 to 7.2 per cent in 2002 (WTO 2007).[2] However, although the number of Indonesia's applied MFN (most-favoured nation) tariffs under 10 per cent decreased from 83.4 per cent of the total tariff lines in 2002 to 75 per cent in 2006, the share of duty-free tariff lines remain at 22 per cent.[3] In addition, there is evidence that tariffs dispersion[4] has increased since 2002 (World Trade Organization 2007).[5] While tariff rates have gone down (or at least maintained), non-tariff barriers have flourished. Agricultural sensitive products, such as rice, cloves, sugar, corn, and soy beans, have been subject to special import licensing; with exclusive import rights being granted to domestic producers in the cases of the former three (World Bank 2006).

Against this background, it would be unwise to assume that pressures for trade protection will subside soon. Resistance to market reform from protectionist groups cannot be underestimated. These groups are still prevalent and hold some key positions both in the government and in the business sector. This was indicated by the reemergence of protectionism after the 1997/98 economic crisis, especially in 2001 to 2004. This chapter aims to seek the explanation behind such a phenomenon by drawing on the cases of rice and fuel. Of course, following the recent 2008–09 world economic crisis, protectionism has been even more exacerbated in many countries, including Indonesia. However, this chapter only discusses the rather longer tradition of rice and fuel protection in Indonesia and not the recent call for protection from industry in general. Rice is the most "politicized" commodity in many countries in the world, including Indonesia. For this country, rice not only continues to be the most important staple food, but it is also the main source of living of small farmers and agricultural households. Warr (2005) stated that in Indonesia, rice represents 7.2 per cent of average consumer expenditure and the rice sector employs 7.1 per cent of the total workforce on farms alone. Rice is also the main job sector for the poor. It is known that 35 per cent of poor people work as rice farmers, while 33 per cent farm other commodities,

and 32 per cent are non-farmers. In addition, among the key basic staples, rice consumption accounts for a major portion of household expenditure. The domestic need of rice per capita is around 140 kilograms, while those of corn (for food) and soybean are 22 and 8 kilograms, respectively.[6] This all suggests that rice is a very important commodity for Indonesia. However, the country is in fact a net importer of rice.[7] Furthermore, more than three-quarters of the poor are net consumers of rice (World Bank 2007a), so the rice price increase must have hurt the poor on average (Basri et al. 2004). One can therefore expect strong resistance towards trade protection on rice.

The reverse is true, nevertheless. Rice has been protected since 2000, and yet there appears to be little resistance, if any, from consumers. Then what determines rice protection in Indonesia? A political economy model mostly points to "politics" as the cause, arguing that governments form trade policy in response not only to concerns about social welfare, but also to pressures from special interest groups. The political support function model for example argues that government acts as an intermediary to balance various conflicting groups in the society in order to maximize political support (Hillman 1982). The government's objective function takes into account the favoured treatment of organized industry as well as the welfare consequences for consumers.

In the case of fuel pricing, the government has implemented policy aiming to protect consumers from higher international prices by subsidizing domestic consumption in the form of reduced and administered prices (applied to especially gasoline, diesel oil, and kerosene). Presumably such policy was motivated as a way to pass the rent from oil resources on to the constituents as Indonesia was an oil-abundant country. The government did this through its oil company, Pertamina, by subsidizing the prices of gasoline, diesel oil, and kerosene such that the domestic prices were below the international market prices.

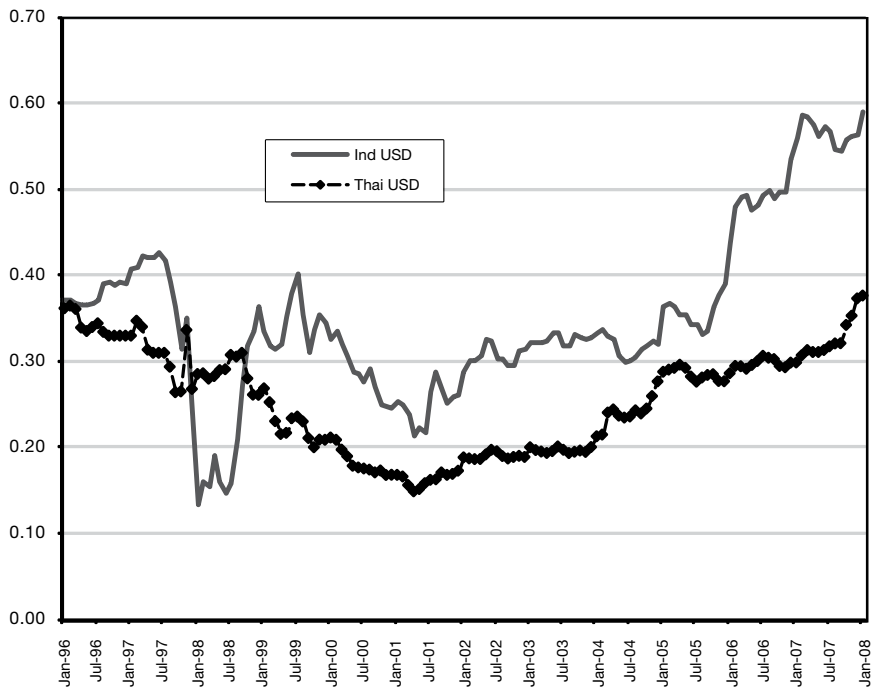
However, the objective is barely met as the subsidy has been significantly regressive and mis-targeted, i.e., it mainly benefits the better-off. In addition, such rationale has lost its relevance, for now Indonesia has become a net oil importer.

This chapter aims to elucidate conflicts over trade protection on rice after the economic crisis and to examine why there is strong pressure against trade liberalization on the rice sector in Indonesia. To provide an illustrative comparison, the chapter also discusses fuel pricing. This contrast is constructive as traditionally the rice protection has been in the form of keeping the domestic price high, i.e., to protect farmers, while the fuel protection takes just the opposite: protecting the general consumers from high prices.

RICE PROTECTION

The Indonesian rice sector was basically liberal in 1998 following the IMF structural reform package. As mentioned earlier the structural adjustment included the removal of various trade barriers in agricultural products, including rice. However, the relatively liberal period was short-lived. Worrying about a massive influx of imported rice, the Indonesian Government started to impose a specific tariff of Rp430 per kilogram in 2000 (subsequently, in January 2005, the Ministry of Agriculture raised the tariff to Rp450 per kilogram). This policy was enjoined by non-tariff barriers (NTB) such as import arrangement, control, and restriction. In 2004, the Ministry of Trade and Industry issued a decree which effectively prevented imports except when explicitly authorized by the Minister. Due to large stock levels prior to the increase in NTBs in January 2004 plus a very good harvest, there seemed to be no price pressure during 2004. But the price response started in the second half of 2005, as the stock was beginning to thin (Figure 8.1).

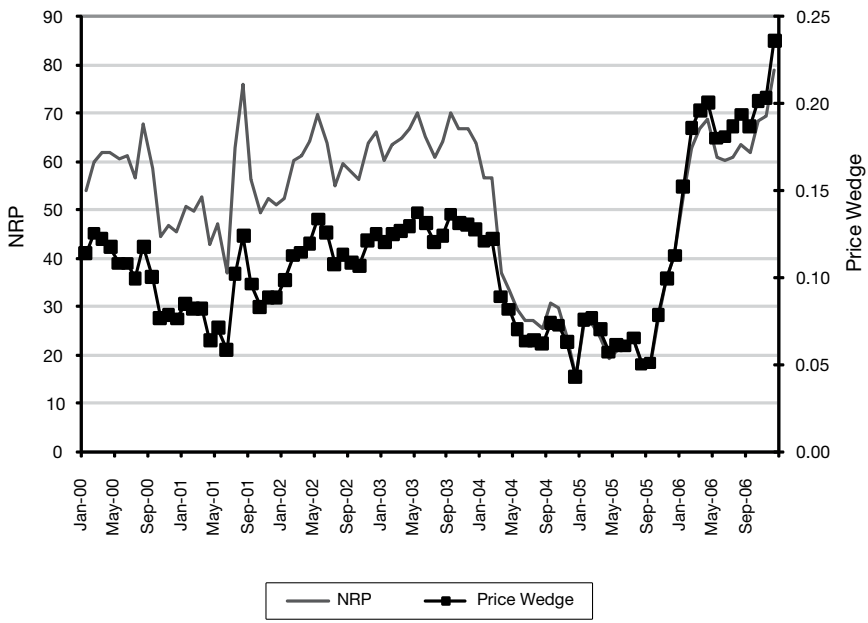
FIGURE 8.1
Domestic and International Prices of Rice



Source: Bulog website (www.bulog.co.id).

The impact of government policies on the rice price is measured by the nominal rate of protection (NRP), defined as the percentage difference between the domestic price and the world price at the border converted at the official exchange rate. The NRP is negative when rice is taxed and positive when it is protected. One shortcoming of measuring the rate of protection by simply comparing the domestic price and world price is that it does not accurately capture the impact of NTB's or subsidies, which are generally part of trade protection. Nevertheless, if the NTB reduces available supplies, prices will respond such that the NRP would in fact reflect the existence of NTB. On the other hand, if the subsidy does not affect the price, it will not be captured; however, in the case of rice, there were not many subsidies, so the impact would be negligible. Therefore, we decided to use such simple NRP in this analysis, as it allows for the examination of the time series path. Figure 8.2 shows that the increase of NRP was consistent with the price diversion between the domestic and world prices.[8] For example, NRP increased substantially after the Indonesian Government imposed an import

FIGURE 8.2
Nominal Rate of Protection and Price Diversion



Source: Bulog (www.bulog.co.id), Bank Indonesia (www.bi.go.id).

tariff in 2000. A similar pattern also appeared in 2006, when the domestic and world prices diverged substantially after December 2005 due to shortages in domestic supply, partly caused by a government ban on rice importation (World Bank 2007*a*). This figure suggests that the domestic price of rice is affected by trade protection.

Who Is Protected?[9]

The Indonesian Government has two objectives in relation to rice. First, it wants to maintain a national stockpile to deal with disasters and to ensure access for the poor to rice. Second, it wants to stabilize the domestic price at levels considered reasonable for both producers and consumers.[10] In 2006, due to budget stringency, the government allowed for maintaining a stock well below the "iron stock" level.[11] But much of the previous limited stock had been used up in helping the victims of natural disasters. After long deliberation, the government decided to import large amounts of rice in order to keep to the budgeted stock level. As has been the case in the past, this created much controversy, with strong opposition from the Indonesian Farmers Association (Himpunan Kerukunan Tani Indonesia, HKTI), Indonesian Farmers Union Federation (Federasi Serikat Petani Indonesia, FSPI), members of the legislatures, and several non-government organizations, as well as independent observers. As always, the debate was around the close connection between the rice price, imports, and poverty.

The number of people living below the poverty line increased from 16 per cent in February 2005 to 17.8 per cent in March 2006, as reported by the Office of Statistics. The World Bank (2007*a*) argued that around 77 per cent of the rise was accounted for by the increasing price of rice. In fact, the price of rice increased by no less than 33 per cent during the period (Mallarangeng et al. 2006). Basri and Patunru (2006) went on to conclude that the surge in rice price was a consequence of the rice import ban imposed by the government in late 2005. Thus, contrary to its stated intent, this policy hurt the poor significantly. Who it seemed to protect instead was richer farmers, absentee landlords, and a few other interest groups. It may be true that higher prices lead to increased farm employment as rice output expands in response. But a study by Warr (2005) has shown that, even after taking the employment effect into account, the rice import ban still increases the incidence of poverty.

It is remarkable, however, that opposition to rice import always gets big attention and news coverage. No matter how sensible the decision to import rice, political interests always create obstacles to its implementation. To make

things worse, government officials often make confusing statements. The government claims that the imported rice will not affect the domestic rice price. Of course this is a contradiction to the stated objective of the policy itself, namely to stabilize prices. Rice traders know that the purpose of having the stockpile is precisely to push prices down if they become too high, and to provide a supply of heavily subsidized rice to the poor and those stricken by natural disasters. So they make their own adjustments as soon as the intention to import is announced. Knowing that demand for market-sourced rice will decrease because consumers will be supplied by the government, they decrease their buying price even before the import policy becomes effective.

Some recent developments have been encouraging, however. Unlike the case in 2005/06 and before, the government seems to be more careful in managing expectations regarding rice imports. In April 2007 the Ministry of Trade signed a memorandum of understanding (MOU) with the Vietnamese Government that allowed Indonesia to import up to one million tons of rice per year until 2009 (Media Indonesia Online, 6 April 2007). Prior to the MOU, the maximum import from Vietnam was 500,000 tons. The decision was made without too much noise beforehand, and afterward the Minister held a press conference stating that Indonesia would import "only when needed". In May 2007, the Vice President even went further to state that the government would directly import rice whenever the "iron stock" fell below one million tons or the domestic price went beyond Rp3,500/kg (Media Indonesia Online, 10 May 2007).[12] Finally, on 31 August 2007, the Coordinating Minister for Economic Affairs issued a letter granting an import monopoly right back to Bulog (the government-run logistics agency for basic foodstuffs). More interestingly, the letter also stated that Bulog is allowed to purchase rice to keep a stockpile of at least one million tons and to take measures to stabilize the rice price without having to get consent from higher authorities (i.e., permission from the Minister of Trade, Ministry of Finance, or Ministry of State-Owned Enterprises — a process that usually invited public controversy). Not surprisingly the Minister of Agriculture reacted strongly against this policy. Citing production data that indicated a surplus in rice production, the Minister told the media that he had asked Bulog to stop importations (*Kompas*, 5 November 2007).[13]

More interestingly, however, there has been a reversal of the protectionism tone from an import ban to an export ban, recently. Following a significant surge in commodity prices, including that of rice at the end of 2007 and the first half of 2008, suddenly the public discourse was filled with calls for an export ban — most of which came from those who had been calling for import bans previously. The rationale used was of course protecting the

consumers (and in some instances to hedge against world price volatility). As in the case of import bans, this opposite call was also entertained by the government. This is interesting as it reflects that "ideology", if any, has its threshold: there is a price level that can force the government to realize the negative impact of high price to consumers. Of course, there might not be any fixed threshold of price in practice; as it would be endogenous to the consumers' willingness to pay, which is hard to measure and not the objective of this chapter.

Distributive Consequences

Understanding who gains and loses from trade protection is important to help explain the determinants of rice protection in Indonesia. The standard political economy model of trade protection normally focuses on simple short-run, profit-seeking activities. However, the reality is considerably more complex, as is evident in the Indonesian context. We therefore need to look at the distributive consequences of the reform.

Support for, or objection to, trade reform is determined by the distributional impacts among various interest groups. This approach argues that the politics of trade liberalization usually focuses on the conflict among interest groups attempting to increase their share of the national income. In other words, trade liberalization is closely associated with income distribution (Rodrik 1998). The distributive consequences framework argues that some groups will be hurt by trade reform and so will oppose it, while other groups will benefit and therefore support it. From the policymakers' viewpoint, the pure reallocation of income is considered a political cost. While, on the other hand, the efficiency gain (as reflected by, say, a more functioning economy) from reform is a political gain. Although this framework can help configure the winners and losers from trade reform, it has its own limitations. As Rodrik (1998) admits, by its very nature, trade liberalization creates a lot of winners whose identity cannot be predicted prior to the reform. For example, after the medium or even long term, some import competing industrialists could transform themselves into export-oriented industrialists, and eventually support the reform.[14] The full configuration of winners and losers only becomes apparent after the reform takes place.

With that qualification regarding distributive consequences approach, Table 8.1 roughly summarizes the expected winners (W) and losers (L) of import protection on rice in post-crisis Indonesia.

It should be obvious why net producers and the Ministry of Agriculture (MOA) are considered winners while net-consumers and the Ministry of Trade (MOT) losers. The case of the Ministry of Finance (MOF) is less trivial.

TABLE 8.1
Expected Winners and Losers from Rice Import Protection

Group	*Expected result*
Government	
Ministry of Finance (MOF)	0
Ministry of Trade (MOT)	L
Ministry of Agriculture (MOA)	W
Net Producers	
Farmer-landowners	W
Farmer-traders	W
Net Consumers	
Landless farmers	L
General consumers	L

Notes: W is winner, L is loser.

It is true that in other trade protection MOF gains from increased revenues, but in rice protection it is non-tariff barriers that dominate. In such a case, the MOF will not reap such benefits.

It is interesting to note here that from 2001 to 2004 the non-tariff barriers fell directly under the authority of the then Ministry of Trade and Industry (Ray 2003). In the current administration, however, the Ministry of Trade and Industry has split into a Ministry of Trade and a Ministry of Industry. The MOT tends to support open trade regimes as evident in various measures to continue economic deregulation and to reduce some of the non-tariff barriers. For example, after a heated debate between MOT and MOA, the rice import ban was eased somewhat in November 2005 and December 2007 as MOT issued import permits to Bulog to allow imports amidst the high domestic price.

Trade reform unambiguously provides economic gain to net consumers of rice, because they could buy rice at international prices, which were lower than the domestic prices. On the other hand, it might be expected that net producers would oppose the trade reform. Table 8.2 shows that for the country as a whole, 81.6 per cent of total households are net consumers of rice. The percentage was higher in urban areas (92.5 per cent) than in rural areas (62.5 per cent). Even, 24.7 per cent of the rice-growing rural households were net rice consumers. Since nearly two-thirds of farmers are net consumers of rice (McCulloch 2008), the rice import protection will definitely hurt the poor and near poor and will only give a benefit to net producers, which are in general non-poor.

TABLE 8.2
Numbers of Households that Produce and Consume Rice

Area	*Net consumers*	*Growing rice* *Net producers*	*Total*	*Not growing rice*	*Total*
Urban (HH)	468,101	1,295,589	1,763,690	21,633,220	23,396,910
percentage	*2.0*	*5.5*	*7.5*	*92.5*	*100.0*
Rural (HH)	2,874,932	8,772,530	11,647,462	19,299,787	30,947,249
percentage	*9.3*	*28.2*	*37.5*	*62.5*	*100.0*
Total (HH)	3,343,033	10,068,119	13,411,152	40,933,007	54,344,159
percentage	*6.2*	*18.4*	*24.6*	*75.4*	*100.0*

Source: World Bank (2007*a*), based on Susenas, 2004.

These facts are hard to explain using the standard model such as the political support model (Hillman 1982, Grossman and Helpman 1994) that argues that government acts as an intermediary to balance various conflicting groups in society in order to maximize political support between welfare of the society and interest groups. The government's objective function takes into account the favoured treatment of organized industry as well as the welfare consequences for consumers.

Furthermore, this result obviously contradicts the median voter model developed by Mayer (1984). The model argues that trade policy is the outcome of majority voting among the population. If the majority of the population are net consumer, especially the poor, the government should tend to support trade liberalization on rice. Nevertheless, the reverse is true in the case of Indonesia.

Although the distributive consequences of reform approach helps us understand the gainers and losers from rice protection, it does not provide an explanation of why the government imposes trade protection on rice. It is thus very important to elucidate in more detail factors that determine rice protection in Indonesia.

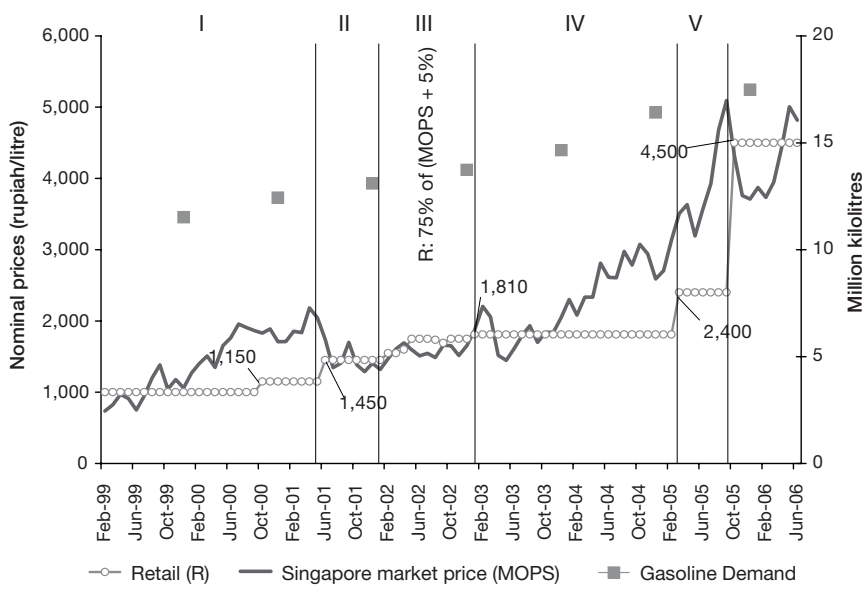
FUEL PROTECTION

As noted above, the government objective to control the price of fuel is to protect the consumers from the high international price and — at least before Indonesia switched from net exporter to net importer — to pass on the rent from oil revenue to the people. As a consequence the domestic price

has been in general below the international price. Figure 8.3 shows that from 1999 to 2005 there have been at least five pricing mechanisms for gasoline where, except in brief periods, the retail price is kept below the benchmark international price, namely the Singapore-quoted Mid-Oil Platts (MOPS). The same approach with different price levels is applied to diesel oil and kerosene (World Bank 2007*b*). The other types of fuels, such as aviation turbine fuel, are considered less sensitive to general demand, and therefore its price is floated following the international dynamics.

Obviously, keeping the domestic price below the international market price entails subsidy. As reflected in Figure 8.3 it would be difficult for the government to maintain the price too low below its international benchmark, as it will severely affect the state budget.[15] During the course of 2003–04 for example, the wedge between the international and the existing domestic prices was increasing rapidly. That prompted the government to adjust the administered price in March 2005, followed by another surprisingly large adjustment in October 2005.

FIGURE 8.3
Domestic and International Price of Gasoline

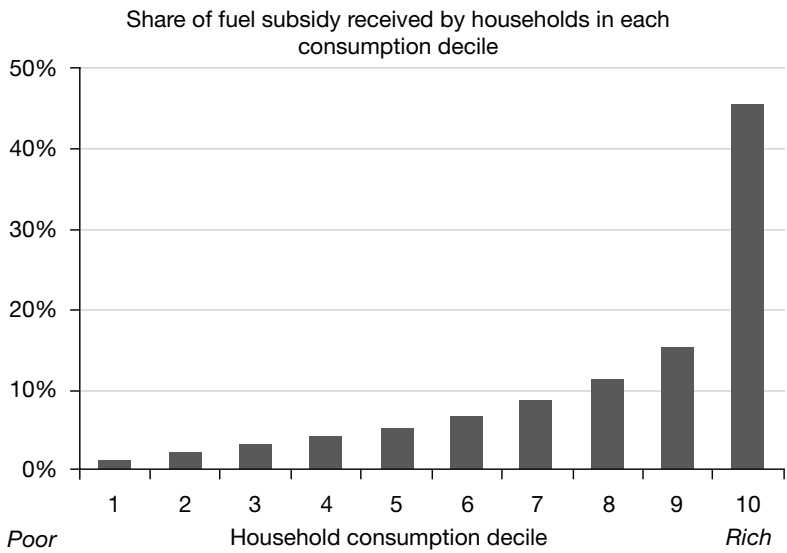


Source: World Bank (2007*b*).

But the impact to the nominal amount of subsidy should not be the main concern. What is more problematic is the distorting effect of the subsidy and even more important is the mis-targeting of the huge amount of subsidy spent. On the distorting aspect, it has been widely known that the fuel subsidy takes up the majority of the money allocated for welfare programmes. It would have been better to use at least part of the money for more productive sectors such as basic education and health. The second concern, and also related to the distorting aspect, is the distributive impact of the subsidy. Studies have shown that the fuel subsidy programme has been benefiting the better off proportionally more than the poor. Figure 8.4 shows that the tenth decile of income groups, i.e., the wealthiest, actually enjoyed the biggest share of the subsidy, while the first decile, the lowest income group, is only affected marginally. Obviously the scheme is regressive, at the cost of the poorest.

This fact is clearly known by the government. In fact before the significant adjustment of fuel prices in October 2005, the government had campaigned about the extent to which the existing subsidy scheme had only been good to the ones who did not need it the most. It took a long battle before the

FIGURE 8.4
Fuel Subsidy and the Poor



Source: Agustina et al. (2008) based on Susenas 2007.

government decided to make the bold move, which then invited wide acclaim. To hedge against the negative impact of the removal of the big subsidy, the government provided a direct cash transfer programme. The programme has been regarded as one of the most successful "high volume" compensation programmes thus far.

Many observers and commentators have blamed the October 2005 price adjustment as being the prime cause of the significant increase in the inflation rate and thus the poverty rate. However, studies have shown that the economic effect was short-lived. In fact, more than two-thirds of the increase in poverty rate was due to the rice import ban, not the fuel price adjustment (World Bank 2006, 2007*b*; Basri and Patunru 2006; Mallarangeng et al. 2006).[16] The massive critiques to the government policy nevertheless continued for months after the decision. Learning from this, the government many times stated in the media that there would never be another price increase. As a result, when the world oil price surged significantly in the last quarter of 2007 and the first half of 2008 and as the burden on the budget was increasing rapidly, the government was reluctant to make an adjustment. In fact, the President himself appeared in public giving his promise not to increase the fuel prices. But in March 2008 the government finally had to amend the oil price assumption in the state budget from the otherwise unrealistic US$60 per barrel to US$95 per barrel. And to complement this, the government increased the fuel prices in May 2008.

Beginning late August 2008, however, the world price started to go down again. Immediately the public demanded a reduction in fuel prices. Despite it being a good time to move the domestic price closer to the international price, the government opted to entertain the call. In December 2008, President Yudhoyono himself appeared in public to announce the cut in domestic fuel prices. He did it twice in December and yet again in January 2009. This series of reductions — three times in two months — was politically smart: it immediately boosted the popularity of President Yudhoyono — who was running for his second term presidential bid.

However, such a move is very likely to be economically harmful, especially in the longer run. In addition to adjusting the price assumption of crude oil to US$45 per barrel in the state budget and cut the retail, administered prices, the government also set a cap on the price. For example, in the case of premium gasoline, the government has reduced the price to Rp4,500 per litre. But they also put a cap of Rp6,000. That is, when the world market-equivalent domestic "economic price" hit Rp6,000, the government would again impose a subsidy just like in the previous pricing regimes.[17] This is very risky on two counts.

Firstly, the definition of "economic price" used by the government (and widely followed by the media) is false and misleading. Instead of using the more economically sensible concept of "opportunity cost" of producing fuel domestically (e.g., Esfahani 2001), the government used an accounting approach as we simplify in Table 8.3 for the case of premium gasoline. The "economic price" is there defined as the world crude oil price adjusted to domestic retail price taking into account an "alpha" percentage (this is a "margin" given to Pertamina, the state-owned oil company for "distribution and operation expenses"), and two small taxes, 5 per cent VAT ("PPN") and 10 per cent fuel tax for motor vehicles ("PPKB"). The existing alpha is 9 per cent ("Sim 1" in Table 8.3), but Pertamina is requesting an adjustment to 13.4 per cent (Sim 2) — presumably to increase their net revenue. Under the official assumptions of exchange rates (Rp11,000/US$1) and oil price (US$45 per barrel)[18] in the approved state budget and with the conventional US$10 additional per barrel for oil as it reaches the Singapore market, the two scenarios end up with Rp4,790 and Rp4,983 per litre, respectively. These, compared to the administered retail price of Rp4,500, entail significant reduction in subsidy.

Secondly, the assumption of oil price at US$45 per barrel is debatable or may not be sustainable, given the high volatility of world crude price. It is true the current oil price has gone below that level. However, the risk of an upswing is still very high (in fact in June 2009 oil prices again approached

TABLE 8.3
Rough Calculation of "Economic Price": Premium Gasoline

	Sim 1	*Sim 2*	*Sim 3*
(a) Assumption: alpha (%)	9	13.4	13.4
(b) Assumption: exchange rate Rp/US$	11,000	11,000	11,000
(1) World Crude oil price (US$/barrel)	45	45	75
(2) Singapore MOPS (US$/barrel) = (1) + US$10	55	55	85
(3) Plus Alpha = (2) + (a)*(2)	59.95	62.37	96.39
(4) US$/litre = (3) / 159	0.38	0.39	0.61
(5) Rp/litre = (4) / (b)	4,147.48	4,314.91	6,668.49
(6) With PPN = (5) + 10%(5)	4,562.23	4,746.40	7,335.34
(7) With PBBKB = (6) + 10%(6)	4,790.34	4,983.72	7,702.11

Note: Sim 1 is the base scenario, Sim 2 is the same as Sim 1 but with alpha changed to 13.4, and Sim 3 is the same as Sim 2 but with world oil price set at the long-run marginal cost estimate (calculated by Sanford C. Bernstein & Co (*Financial Times*, 15 October 2008).

US$70 per barrel). A recent econometric study has concluded that the world real oil price follows a random walk with a standard deviation of quarterly change as wide as 15 per cent (Hamilton 2008). As a consequence, it is very hard to predict future oil prices. In fact, if one assumed an average price of US$115 per barrel in the last quarter of 2008, then he could only say that the price four quarters afterwards would stay the same but with lower and upper bounds of US$34 and US$391 respectively.

A research and wealth management company, Sanford C. Bernstein & Co., has produced a report whereby they showed that the long-run marginal cost of oil supply is now US$75 per barrel. Taking this into the government's "economic price" calculation, one would get a retail price of Rp7,700 per litre — around Rp3,000 subsidy per litre. In fact, if we calculate the "economic price" using the more economically sensible "opportunity concept", one would end up with a similar subsidy amount. In Table 8.4 we compared the Indonesian gasoline retail price with those in neighbouring countries. The opportunity cost concept dictates that the relevant market price is the average of prices everywhere (Esfahani 2001). Deviation from such an average would imply net subsidies or net taxes. For illustrative purposes we only take some countries as comparison and add the U.S. case as another benchmark.[19] The average retail price (converted to rupiah, 25 January 2009) was between Rp7,600 and Rp7,800 per litre. Again, for Indonesia, this implies a subsidy of around Rp3,000 per litre.[20]

TABLE 8.4
Gasoline Prices: International Comparison

	US$/litre	*Rp/litre*	*Implied Subsidy/ litre*
Singapore	0.50	5,360.50	2,286.68
Indonesia	0.42	4,500.00	3,147.18
Malaysia	0.66	7,075.86	571.32
Philippines	1.22	13,079.62	–5,432.44
Vietnam	0.81	8,684.01	–1,036.83
China	0.67	7,183.07	464.11
U.S.	0.80	8,576.80	–929.62
	Average	7,779.98	
	Excl. US	7,647.18	

Note: Based on quoted retail prices from various sources, 25 January 2009.

WHAT FACTORS DETERMINE RICE AND FUEL PROTECTION IN INDONESIA?

This section discusses two factors that might explain the trend of rice and fuel protection in Indonesia. First, it discusses the relation between the demand for rice and fuel protection and the movement of the real effective exchange rate. Second, it attempts to explain the government protectionist motive using the collective action framework.

Real Exchange Rate and the Demand for Protection

The demand for protection is closely associated with the movement of the real exchange rate. Corden (1997) and Rodrik (1998) argue that macroeconomic effects cannot be ignored when a country with a wide-ranging system of tariff and non-tariff barriers implements trade liberalization. Corden (1997) also argues that, if the real exchange rate does not change and the total real expenditure stays constant, a reduction in import protection will shift demand towards imports while the output of import competing industries will decline and the current account will deteriorate. These effects prompt the rejection of trade liberalization. However, the movement of the real exchange rate can alter this pattern. For example, a real depreciation can reduce the demand for import protection. Corden (1997) then suggests that the exchange rate must either be devalued, or allowed to depreciate sufficiently when the pressure for import protection is high. Therefore, trade liberalization should normally be a part of a policy package which includes adequate depreciation. This argument can be formally explained as found in Appendix 8.1.

To investigate the relationship between the real effective exchange rate (REER) and nominal rate of protection (NRP) we conduct a simple test on rice based on monthly data from January 2000 to December 2006. Unfortunately such a test is less justified for an application on fuel price data as the time series lack variation. This is so because the domestic fuel prices are administered and hence change much less frequently. In addition, the pricing of fuel by the government has been mostly affected by the dynamics of world crude oil price relative to the changes in exchange rates.

The NRP of rice is hypothesized to depend on REER that is itself defined as a basket of foreign currencies to the rupiah. Thus we expect there is a positive relationship between NRP and REER, in which appreciation of rupiah REER will induce demand for protection as argued above. This hypothesis could not be rejected as we regress the change of nominal

rate of protection (DNRP) on the change of real effective exchange rate (DREER) as shown in Appendix 8.2. Hence there is a positive relationship between the change of NRP and the change of REER.

This result of the simple econometrics on rice is also consistent with David and Huang (1996) who argue that NRP will decline if domestic price does not increase proportionally with the depreciation of domestic currency. Figure 8.3 plots the trend of the nominal rate of protection and the real effective exchange rate. Again, it shows that the trend of NRP of rice is consistent with that of the real effective exchange rate. When the rupiah real exchange rate appreciates (i.e., fewer rupiah per U.S. dollar), the NRP also moves in the same direction. NRP tends to increase when Indonesia's REER appreciates. This was particularly true in 2006 when the REER appreciated by almost 90 per cent of its value prior to the economic crisis. This means the demand for protection increases as the rupiah becomes stronger, because a strong currency makes the given country's goods relatively more expensive. This is why Corden suggests weakening of domestic currency to reduce protectionism pressure.

While REER can partially help us explain the change of NRP from time to time, two caveats present themselves. First, it does not provide a ground for us to understand why the government tends to protect the minority of the population while hurting the poor and near poor, an important variable of concern if they want to be re-elected in the next general election. Second, it should be noted that the relationship between NRP and REER can also stem from the definition of NRP itself as the percentage difference between the two prices, converted at official exchange rates. So there is an exchange rate element in the construction of the NRP. Simultaneity bias should be less likely, however, as the way REER is constructed is different from the nominal exchange rate.

Weak Consumers, Strong Producers

At first, it seems rather counter-intuitive that in a country like Indonesia whose population is dominated by rice net consumers, protection in the form of rice import restriction is persistent. At the same time, despite the mis-targeting of protection in fuel pricing, such protection has been maintained. Standard political economy approaches such as the political support model and majority voting model fail to give satisfactory framework to address this issue. Here we offer another approach, originating from the work of Olson (1965), the logic of collective action. We argue that despite its larger size of

group, the net consumers fail to form a coordinated coalition due to low incentives to do so and thinly dispersed expected benefits. On the contrary, net producers — or more precisely interest groups claiming to act on behalf of (net) producers — have a size small enough to suppress coordination costs and reap "lumpier" benefits and therefore are more effective in influencing the government. In this context, the "collective good" (in Olson's sense) for the group of net consumers in the rice context is a lower rice price, while that for the net producers group is a higher price.[21]

To help the analysis, it might also be useful at this point to refer to Olson's taxonomy of groups. His "privileged" group is a group where an individual member has an incentive to see the provision of the collective good, even if he has to bear the full cost alone. Here, coordination is not necessary. In the "intermediate" group on the other hand the incentive to bear the full cost of providing the collective good by oneself exceeds the shared benefit. In this case, there should be coordination (e.g., organization). Finally, in case of a "latent" group, the size is very large such that any action of one particular member will not significantly affect others. Thus, no one has an incentive to bear the cost of collective action necessary to provide the collective good. It is reasonable to think of the group of net consumers in Indonesia's rice case as being the latent group, while that of net producers as either the privileged or intermediate group. In the case of fuel pricing, a more general taxonomy is needed: the larger group of poor as the latent group, while the smaller, richer group is the latter.

By the logic of collective action (see Appendix 8.3), the group of rice net producers that is smaller in size than that of net consumers is easier to coordinate among the members in order to get their collective good — in this case a higher price of rice. It is interesting to see that in the Indonesian context, this group seems to fit with Olson's typology of both privileged group and intermediate group. That is, there seems to be a subgroup in the net producer group to which the relationship resembles a privileged group whose individual members are willing to pay the full cost of providing the collective good. This subgroup attitude is indicated by farmers' associations such as HKTI and, to a lesser degree, FSPI. But in the larger, main net producer group, the relationship is more akin to an intermediate group, i.e., coordination is needed to achieve the group's objective. It is therefore not surprising that the leaders of organizations like HKTI or FSPI frequently lobby the government or indirectly via statements in the media, even without apparent coordination across organizations beforehand. But it takes time to make any political move in a grander scale since it involves the larger group of producers and hence more costly coordination.

CONCLUSION AND POLICY IMPLICATION

We have constructed an argument that can explain the case of Indonesia's rice protection, i.e., import restriction as well as fuel pricing. We offer two explanations. First, it shows that the demand for the import protection tends to increase when Indonesia's real effective exchange rate appreciates. For rice, this was particularly true in 2006 when the real effective exchange rate appreciated by almost 90 per cent of its value prior to the economic crisis. For the case of fuel, due to the nature of protection and hence the data, we were precluded from testing such a hypothesis.

Second, the group of rice net consumers, larger in size, has less incentive to fight against the protection, while on the contrary the smaller group of net producers has more incentive to fight for protection. Due to thinner shared net benefit to individual consumers, each rationally opt for not fighting. On the other hand, the producer group (or more precisely through its subgroups) has more concentrated benefits. As a consequence, the producer group appears stronger than the consumer group. It is therefore predictable that the government takes the side of the producer group and hence hurts the poor. This logic also seems relevant in the case of fuel. That is, the group of poor is weaker than the group of rich and hence the latter has more access to effective protection.

At this point it is rather difficult to draw a policy implication from the analysis. However, if poverty eradication is the objective, one way to reduce the exposure of the poor to the negative impact of rice protection is to provide more leeway and power to consumer groups such as YLKI (The Indonesian Consumers Foundation) to channel the rice net consumers' aspirations. This might require a provision of incentives for YLKI in the sense of "separate" and "selective" incentives (Olson 1965). In the case of fuel it requires a reduction of subsidy complemented by a compensation scheme such as direct cash transfer.

APPENDIX 8.1 EXCHANGE RATE AND TRADE PROTECTION

Following Corden (1997), assume a small country with three types of goods, i.e., exportables X, importables M (both are called "tradables") and non-tradables N whose price is P_N. Let Pm^* and Px^* be the prices of imports and exports, respectively; both are given under small country assumption. The nominal exchange rate is denoted by e, defined as domestic currency per unit of foreign currency. Assume that a single tariff of rate t is applied

to *M*. There are no export taxes or subsidies. Thus, the price of imports can be defined as $Pm=e\ Pm^*(1+t)$ and the domestic price of exports as $Px=e\ Px^*$. The "switching ratio", *S*, is defined as a ratio of the relative domestic price of tradables to non-tradables. The price of tradables is a weighted average of *Pm* and *Px* with the weights of α and $(1-\alpha)$, respectively. Amongst other things, the weights depend on the shares of *M* and *X* in domestic consumption and production. The switching ratio determines the current account and the excess demand-supply situation in the market for non-tradables. It can be written as $S = [\alpha\ e\ Pm^*(1+t)+(1-\alpha)\ e\ Px^*] / P_N$.

In a more realistic world, some given rates of inflation abroad (causing Pm^* and Px^* to continuously increase) and some rate of inflation in P_N can be assumed. As Corden (1997) suggests, it is therefore more useful to introduce the real exchange rate *R*. Assume that the terms of trade constant are constant (so that Pm^* and Px^* always rise to the same extent) and denote the foreign price level as p^*. Thus, $R=e\ p^*/P_N$. Substituting this with the previous equation obtains $S = R(\alpha t+1)$. Therefore, in order to keep *S* constant, a reduction in tariffs (*t*) requires a real depreciation (i.e., rise in *R*). Note that the change in *R* not only depends on *e* but also on the changes in p^* and P_N. So, a rise in *R* (i.e., real depreciation) enables *t* to decline. Real depreciation, therefore, reduces the pressure for import protection.

APPENDIX 8.2 TEST OF RELATIONSHIP BETWEEN NRP AND REER

Table 8.5 shows the relationship between nominal rate of protection and the real effective exchange rate, as discussed in the text.

APPENDIX 8.3 THE LOGIC OF COLLECTIVE ACTION

We shall follow an approach offered by Dixit and Skeath (1999). That is, we shall use a game theoretical framework to formulate the collective action problem. For the purpose of this chapter, we will only look closely to the (net) consumer group. Understanding the conflicting motives within this group is sufficient to understand why the disadvantaged groups have been silent despite the fact that they are hurt by the protection policy. Furthermore, it will automatically provide a ground for understanding why the other group, who benefits from protection, can voice up more effectively (so as to influence the policy outcome in its interest).

Suppose there are two members in the consumer group. Each member can choose either to fight (to "Fight") against protection (in this case, import

TABLE 8.5
NRP and REER

Dependent Variable: DNRP				
Variable	*Coefficient*	*Std. Error*	t-Statistic	Prob.
Constant	–0.323417	0.499132	–0.647960	0.5188
DREER	1.538929	0.145395	10.58446	0.0000
R-squared	0.580378	Mean dependent var		0.303469
Adjusted R-squared	0.575197	S.D. dependent var		6.927577
S.E. of regression	4.515180	Akaike info criterion		5.876568
Sum squared resid	1651.335	Schwarz criterion		5.934854
Log likelihood	–241.8776	F-statistic		112.0307
Durbin-Watson stat	1.802069	Prob(F-statistic)		0.000000

Note: n = 83. Augmented Dickey-Fuller test shows that both NRP and REER are I(1). The cointegration test shows that DNRP and DREER are cointegrated.

restriction) or not to fight (to "Giveup"). These two members can fight together or individually (without coordination). Assume that the costs and benefits of these actions are as shown in Table 8.6. That is, if one member decides to fight alone, he and the other member would expect a benefit of $b1$ each at the cost of $c1$ paid by the fighting member. But if he joins force with the other member, the expected benefit for each is $b2$ at the cost of $c2$ each.

A game table with expected payoffs can now be constructed as follows (Table 8.7). As conventional in game theory, the first element in each cell is associated with Consumer 1, and the second with Consumer 2. Note that if both Consumers 1 and 2 decide not to speak up, each of them will end up having a payoff of d. In this context, d is the cost that has been paid by an average Indonesian rice consumer due to the protection. That is, it is a

TABLE 8.6
Costs and Benefits of Fighting against Protection

	Costs	*Benefits*
Alone	***c*1**	***b*1**
Together	***c*2**	***b*2**

TABLE 8.7
Payoff Matrix for Consumer Game

		Consumer 2	
		Fight	*Giveup*
Consumer 1	Fight	***b*2-*c*2, *b*2-*c*2**	***b*1-*c*1, *b*1**
	Giveup	***b*1, *b*1-*c*1**	***d*,*d***

status quo payoff. (It should not affect the result if we replace d with zero, as we will later.)

The game implies a prisoners' dilemma if the following inequalities simultaneously hold, i.e., $b1 > b2–c2$, $d > b1–c1$, and $b2–c2 > d$. So the best response to strategy "Fight" is "Giveup", the best response to strategy "Giveup" is "Giveup", and the co-strategy "Fight, Fight" (i.e., both members opt for "Fight" at the same time) is jointly preferred to "Giveup, Giveup". Note also that if only they could coordinate, they will prefer "Fight" together to "Giveup" individually if joint net benefit of the former exceeds that of the latter. That is, it is socially optimal for them to "Fight" if $2(b2–c2) > 2b1–c1$.

The implication of the game is that no matter what the other does, one member is better off opting for "Give-up", even though the socially optimal outcome is for each member to fight simultaneously (that is, the Nash equilibrium "Give-up, Give-up" has a total payoff that is less than that of the social optimum "Fight, Fight") . This latter outcome is, however, unlikely because the incentive for each player to fight is smaller than its cost. This seems to fit with, for example, the case of Indonesia's rice consumer problem. No one has an incentive to fight against government protection because the net benefit is thin, even though if everybody fights together, the benefit can be huge. Yet, this latter possibility is unlikely, because it will require a big coordination cost as well.

Again, following Dixit and Skeath (1999) we can extend the foregoing two-person game to a game of a large number of participants. Suppose there are N consumers. Each of them must decide whether to fight (or at least "speak out") against protection. Individual costs and benefits of fighting (or giving up) now are a function of the number of those who fight. If n of N decide to fight, each of them incurs a cost of $c(n)$ and everybody (including those who do not fight) enjoys a benefit of $b(n)$. Therefore, each fighting consumer gets the payoff of $f(n) = b(n) – c(n)$, and each quitter who gives up gets $g(n) = b(n)$. Note that here there is no d: we assume without loss of

generality that d equals zero. This assumption is justified since the protection is already a status quo.

As an illustration, consider a member of the group who is wondering whether to fight or to give up. If he decides to fight, the number of fighters becomes n+1, so he gets $f(n+1)$. If he decide to give up, he gets $g(n)$. Therefore he will fight if and only if $f(n+1) > g(n)$. Otherwise, he will give up.

As in the case of the two-person game above, the prisoners' dilemma in this N-player results in a dominant strategy of "Giveup". That is, no matter how large n becomes, the payoff to any given member of the group is higher should he opt for "Giveup" than if he chooses "Fight". The Nash equilibrium is therefore such that everybody gives up. Note, however, that as n increases, the additional benefit to everybody also increases. It follows that if everyone keeps fighting simultaneously and sustainably, the social outcome is higher than that of the Nash equilibrium. But just as in the two-person game above, this scenario is unlikely. In Olson's words, what is good for the group as a whole might not be good for individual members. This framework helps us to understand why the group of net consumers, larger in size, has less incentive to fight against the protection.

Notes

1. We thank Rick Barichello, Aris Ananta, and participants of ISEAS' Conference on Poverty, Food and Global Recession in Southeast Asia, 25–26 March 2009. We also thank Chris Manning and Indonesia Project group at ANU (part of the paper was written while Patunru was visiting ANU, Canberra, January 2009). Last but not least we also thank the late A.V. Hardiyanto (formerly with Bank Indonesia) and Peter Rosner (formerly with the World Bank) for help in data.
2. It is true that the simple average tariff increased to 9.9 per cent in 2004, but it was due to the adoption of ASEAN Harmonized Tariff Nomenclature (AHTN) as part of Indonesia's commitment under the ASEAN Free Trade Area (AFTA).
3. Applied MFN ("most-favoured nations", a non-discrimination principle under GATT/WTO) rates refer to tariffs faced by an exporter in a target market whereas the country of origin does not benefit from a preferential agreement. The 10 per cent line here is one of the common rates used as a benchmark for tariff reduction schedules by WTO members.
4. Tariff dispersion refers to different applied tariff rates to the same product or same category of products. The higher the dispersion the more difficult it is to alleviate the political motives for excessive protection.
5. Note, however, that it was due mainly to the high tariffs on alcoholic beverages. Excluding these products will reveal a downward overall trend of tariff rates.
6. The corresponding figures for sugar (for consumption) and crude palm oil (for cooking oil) are 12 and 18 kilograms.

7. Indonesia was briefly a net exporter only in 1985–1987 and one shorter period during World War II (Dawe 2006).
8. World prices are for Thai 25 per cent FOB, adjusted with freight and transportation costs of additional 10 per cent in 2000–2001, 15 per cent in 2001–04, and 20 per cent in 2004–06. Domestic prices are for medium wholesale rice in Indonesia. All data are from Bulog.
9. This section draws rather heavily from Basri and Patunru (2006).
10. The Vice-President asserted in September 2006 that the desirable stable price range is Rp4,200–4,300 per kilogram (*Kompas*, 2 September 2006). In July 2007 an official from the Office of Coordinating Minister for Economic Affairs said that the price should be kept between Rp4,500 and 5,000 per kilogram (*Jakarta Post*, 29 July 2007).
11. This is the term used to call the stock at the "safe" level, i.e., the stock that can be used as a buffer when there is a rice deficit. The exact amount can vary from time to time depending on the condition of the rice market.
12. It is surprising, however, that later in June the Vice President promised that Indonesia would become self-sufficient in rice by 2008 (Media Indonesia Online, 19 July 2007).
13. Bulog has been notorious for its corruption cases. It was first established as an independent state agency by President Soeharto in the late 1960s with the main task of stabilizing the prices of basic commodities. In effect, Bulog is an import monopoly of rice, wheat, sugar, and soybeans. Bulog's rice monopoly function was abolished in 1998 as a part of the IMF structural reform package. From 1999 Bulog's right to import rice was not exclusive anymore until it was restored in 2002. In 2003 the government transformed Bulog into a profit-oriented state enterprise albeit still with a series of "social" obligation programmes, most notably the rice procurement programme to be delivered to poor households — a programme that has been a key playground for corruption in Bulog (see for example Olken 2006). Its new status as a "semi-private" agency in fact limited Bulog's effort to maximize profits. The decision by the Coordinating Minister to give back its pre-crisis authority and status was therefore welcomed wholeheartedly by Bulog.
14. It should be clarified here that we are talking about import restriction, not export restriction.
15. See Agustina et al., 2008.
16. These studies documented that between February 2005 and March 2006, there was a 1.8 basis point increase in the poverty index from 16 per cent to 17.8 per cent. At the same time, the rice price increased 33 per cent. With an assumed poverty-rice elasticity of 0.04, then at least 72 per cent of the increase in poverty was due to rice price increase.
17. At Rp4,500 per litre domestic price and US$45 per barrel world price, the government claimed that almost no subsidy had to be provided.
18. Assessment as of 25 January 2009.

19. Presumably, if smuggling is of concern, closer countries are more relevant than those located far away.
20. The exercise in Table 8.4 should be taken cautiously. Ideally we should normalize all with transportation costs, production capacity, etc.
21. In the case of fuel, however, this is less clear, as both groups (richer and poorer) want a lower price.

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9

THE PRICE OF RICE AND POLITICS OF POVERTY IN THE PHILIPPINES

Jorge V. Tigno

This chapter examines the dynamics behind the Philippine Government's rice subsidy programme as a response to the rice price crisis of 2008 and its overall impact on poverty in the country.[1] Rice has always been intertwined with politics in the Philippines (Intal and Garcia 2005, p. 1). Each year since the 1930s, the government attempted to help the poor by making rice available at subsidized prices below prevailing market rates. In doing so, the government has incurred significant administrative losses and has had to justify the same in the name of easing the misery of the poor and alleviating poverty. The chapter also attempts to respond to a number of political and administrative concerns pertinent to the poverty alleviation outlook of the Philippine Government. Can the action taken by the government, particularly in making rice available at reduced (i.e., subsidized) prices to the poor, be an effective poverty alleviation strategy? What political and social factors might explain the emergence of this historically programmed response? Is this action administratively and politically sustainable? The chapter argues that rice subsidies to the poor are not a sustainable option. Such a programme cannot really empower the poor as much as it makes them more dependent on power-holders. Moreover, rice subsidies are not financially viable in the way that they are being implemented in the country. These subsidies do not really target the poor and have in fact become political instruments for making the poor even more subservient.

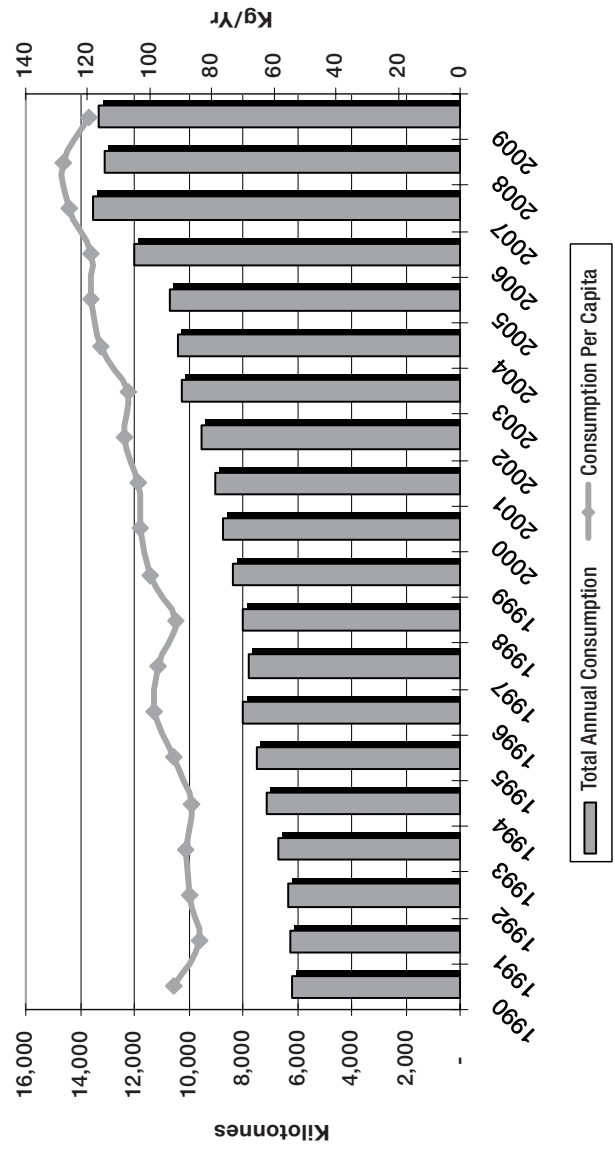
Rice is a unique commodity throughout Asia in the sense that it is able to foster links between society, politics, and economics and does so in three ways (Timmer 2004, p. 19). First, rice is historically the main staple ingredient on many Asian tables. Access to such a commodity on a daily basis thus becomes crucial to policymakers and politicians who increasingly see the need to cater to a demanding public. Second, in many Asian societies like the Philippines, rice is grown predominantly by small landholders. In not a few instances, such small rice farmers constitute the single-largest identifiable segment of the voting population.[2] Third, as the price of rice in the international market has been historically volatile and given the fact that it is a fundamental nutrient source for many people, Asian governments are likely to hedge in favour of acquiring this commodity and controlling its trade across borders.

Compared to most countries in Asia, the Philippines stands out as a major rice-consuming nation. Like most Asian households, rice is an essential part of every Filipino family's diet. But while elsewhere in Asia rice per capita consumption has actually declined (Childs and Kiawu 2009, p. 2), the demand for rice in the Philippines has in fact risen steadily over the decades. Annual per capita rice consumption in the Philippines in 2009 has increased nearly 40 per cent from 20 years ago, while total annual rice consumption had more than doubled over the same period. The annual per capita rice consumption in 1990 was around 92 kilograms. By 2009 the figure had increased to nearly 120 kilograms (Figure 9.1). In 1990, the Philippines consumed over 6.1 million tonnes of rice, but by 2009 this had increased to 13.3 million tonnes as shown in the same figure. On average, the country's total annual rice consumption grew nearly twice as fast as the average rate of increase of its population over almost the same period.

Absolute rice consumption in the Philippines remains high compared to its more affluent neighbours in the region. This says something about the nature and extent of poverty obtaining in the country. Ideally, as the number of high- and middle-income consumers grows, there is a shift to more diverse diets as wheat and potatoes become more affordable and desirable substitutes for rice. This would explain the decline in total per capita rice consumption in highly developed Asian countries. Such a situation does not seem to be the case in the Philippines as many Filipinos remain chronically poor and are thus unable to expand their diet choices to include other food staples beyond rice.

Of all the major issues confronting Philippine development policymakers and administrators, none appears to be more daunting than the poverty problem. Poverty lies at the core of the vicious cycle that puts political

FIGURE 9.1
Total Annual Rice Consumption and Annual Rice Per Capita Consumption, 1990–2009



Source: Bureau of Agricultural Statistics (2010) and U.S. Department of Agriculture (2010).

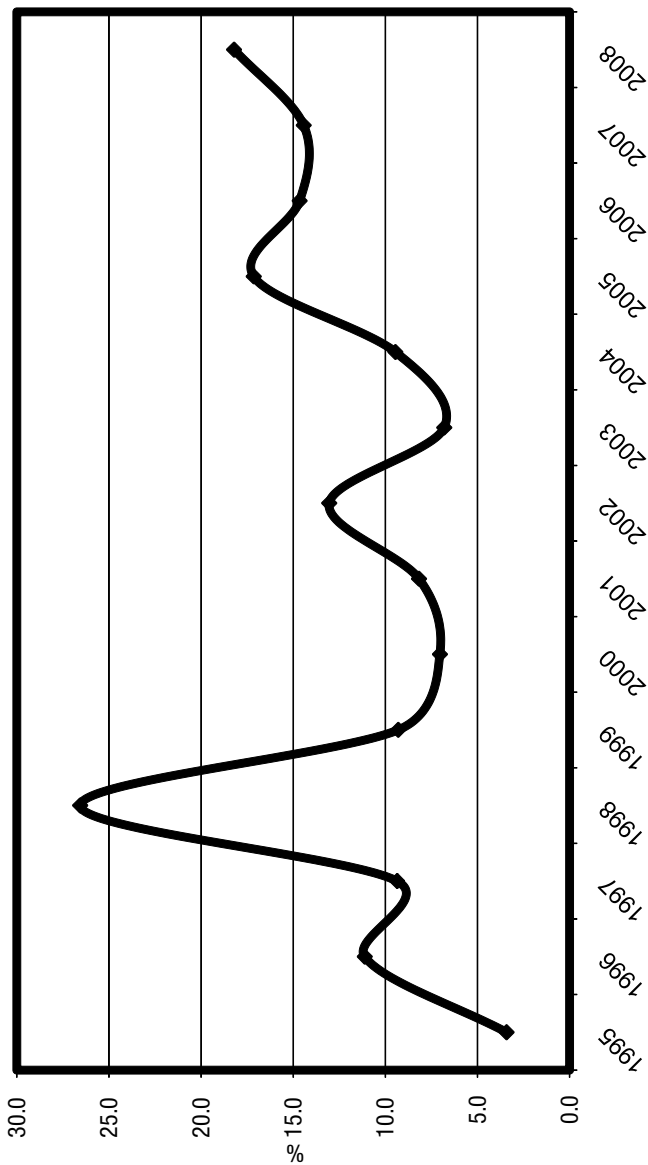
administrators both at the national and local levels to task. Poverty engenders marginalization and disparities which in turn lead to violent political conflicts in major parts of the archipelago, such as in Mindanao in the southern part of the Philippines where a political movement has waged a perpetual war against political and administrative centralism. Beyond simply being an issue of identity incompatibilities, the exclusionary politics that has minoritized the Moros and Lumads of Mindanao, for instance, has been driven by a confluence of factors that also include economic marginalization, migration, and (not surprisingly) poverty. It is no wonder that Mindanao (particularly the region known as the Autonomous Region for Muslim Mindanao, or ARMM) continues to rate poorly in human development terms.

Poverty reduction lies at the heart of the government's national development framework. The fundamental mission set out in the Medium-Term Philippine Development Plan (MTPDP) for the 2004 to 2010 period "is to fight poverty by building prosperity for the greatest number of the Filipino people" (NEDA 2004, p. 1).[3] Poverty-alleviation also lies at the core of many other intervention strategies undertaken by international development agencies such as the Asian Development Bank,[4] the U.S. Agency for International Development (USAID), and the United Nations Development Programme (UNDP),[5] among many others.

Like some of its Asian neighbours, the Philippines imports a significant portion of its rice needs from overseas markets. It has been importing rice nearly every year since the late 1860s (Dawe 2006, p. 4). Since the 1990s, rice imports average around 12 per cent of the country's total annual rice consumption requirements. However, there have been times when the Philippines imports a substantial proportion of its rice consumption needs, such as in 1998 when there was a substantial drop in domestic rice production capacity. The latest peak in rice imports took place in 2008 when the country bought some 18 per cent of its consumption requirements from overseas (see Figure 9.2). This is due partly to the fact that, historically, domestic rice production barely keeps up with rice consumption (see Figure 9.3). At the height of the rice price crisis in 2008, the country imported nearly two and a half million tonnes of rice.

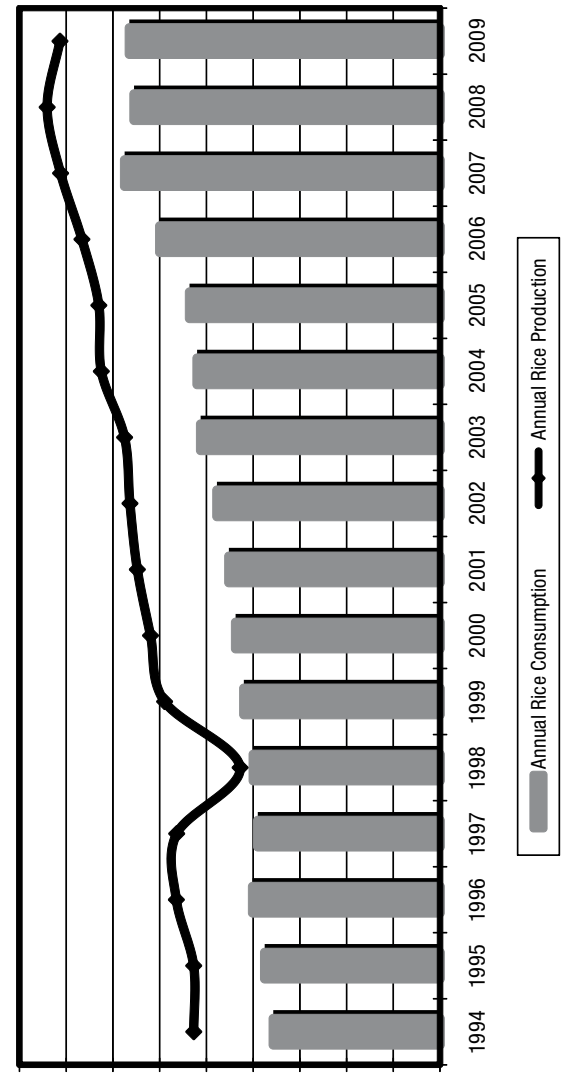
Rice production and consumption have serious implications for the poor in the Philippines. Rice production in the Philippines is generally a function of private land ownership. About two-thirds of rice lands in the country are cultivated by poor tenant farmers or share-croppers (Intal and Garcia 2005, p. 9). The regions that produce the largest volumes of rice are Central Luzon, Cagayan Valley, Western Visayas, the Ilocos, and Central Mindanao,

FIGURE 9.2
Ratio of Rice Imports to Consumption, 1995–2008



Source: National Food Authority (2010) and Bureau of Agricultural Statistics (2010).

FIGURE 9.3
Annual Rice Production and Consumption in the Philippines, 1994–2009



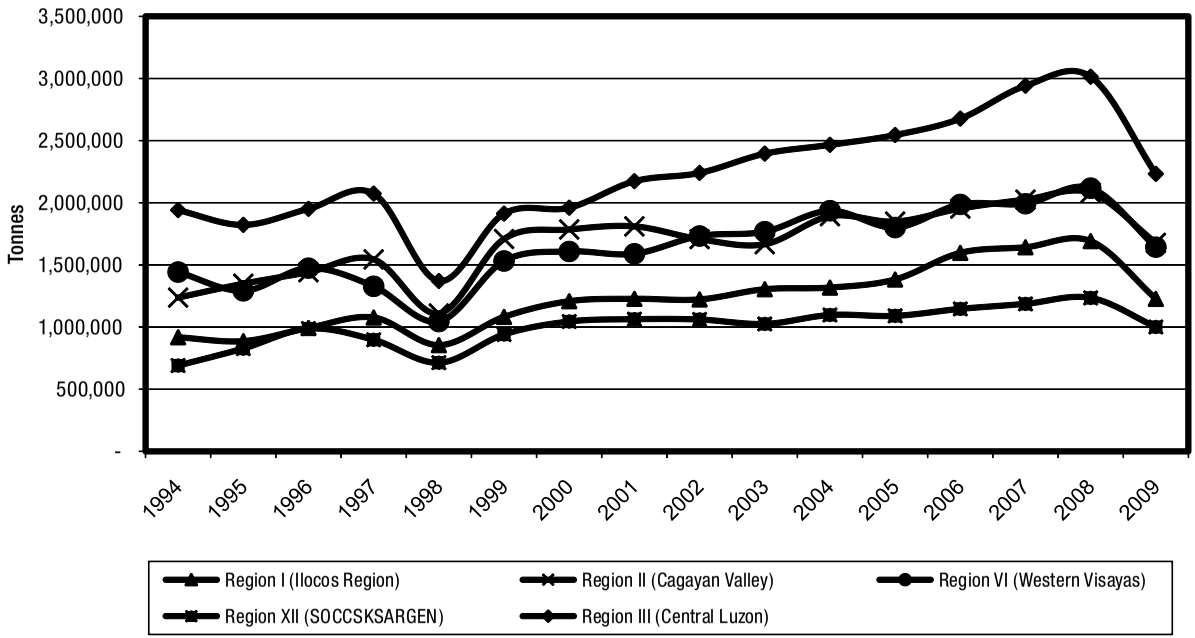
Source: Bureau of Agricultural Statistics (2010) and U.S. Department of Agriculture (2010).

which together make up 60 per cent of the country's total annual rice output (see Figure 9.4). Rice farm holdings in the Philippines are generally small, averaging no more than 5 hectares per farmer household. In 2000, about 67 per cent of the 4 million hectares planted to rice was irrigated. The rest are said to be rain-fed areas making them more prone to climatic shifts (Maclean et al. 2002, p. 119). In historical terms, the size of land nationwide that is devoted to rice farming has remained virtually at constant levels since the 1990s (see Figure 9.5).

This kind of small share-cropping arrangement exposes rice farmers to abuse and exploitation by landlords, rice traders, and blackmarket lending institutions that undercut rice farm earnings (the existence of an agrarian reform law notwithstanding), so much so that domestic rice farming has not become a financially viable venture for the lot of Filipino farmers. Rapid urbanization has also prompted many owners to convert their rice lands to commercial, industrial, and other non-agricultural uses. At the same time, rice production in the country has not undergone any major technological improvements. Small wonder then that rice farm households in the country operate at or below subsistence level and, in an ironic twist, many farmers are forced to purchase imported rice in the open market. At the height of the 2008 rice price crisis, for instance, the Department of Agrarian Reform (DAR) took cognizance of "the unabated conversion of prime agricultural lands for real estate development" and ordered an immediate moratorium on the processing of land use conversion applications (Burgonio 2008), notwithstanding the fact that the total number of hectares harvested to rice nationwide had actually increased by 22 per cent between 1994 and 2008 (BAS 2009*a*).

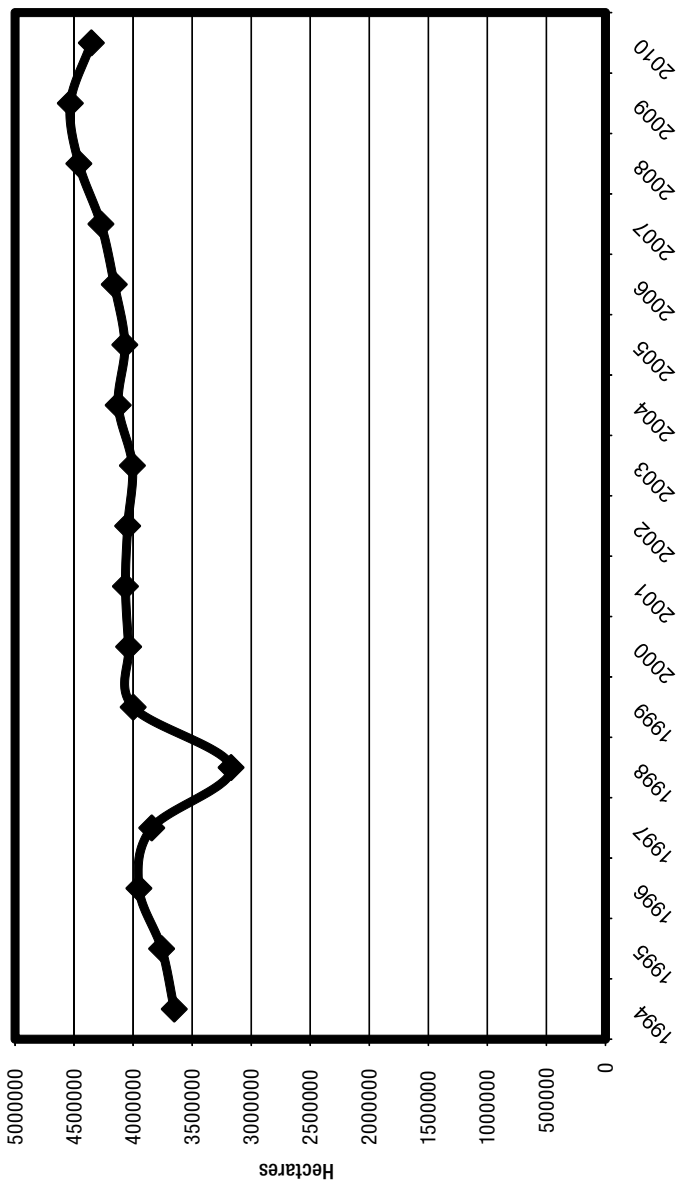
Rice consumption costs eat up about two-thirds of a poor Filipino family's total food expenditures.[6] Nearly a quarter of the total expenditures of poor households in the Philippines are for the purchase of cereals, the most common of which is rice. In general, poor households spend almost three times more on rice than non-poor households. Given that the poor spend proportionally more on rice than the rich, a sudden upward movement in its retail price can have a profoundly adverse effect on the poor more than on any other segment of the population. In 2008, when the rice price crisis began, the market price of rice in the Philippine market jumped by 35 per cent despite the "success" of the national administration under President Gloria Macapagal Arroyo in attaining significant levels of macroeconomic growth. Since taking over as President in 2001, Arroyo had managed to muster an average GDP growth of 4.9 per cent, a rate that is

FIGURE 9.4
Volume of Rice Production by Region, 1994–2008



Source: Bureau of Agricultural Statistics (2010) and U.S. Department of Agriculture (2010).

FIGURE 9.5
Land Area Harvested to Rice, 1994–2010



Source: Bureau of Agricultural Statistics (2009*a*).

comparably higher than figures attained by her predecessors, Fidel Ramos (4.1 per cent) and Corazon Aquino (3.1 per cent) (Adriano 2008).[7] However, doubts remain as to the effect of such macroeconomic figures, especially in the context of the government's increasing inability to address persistent and pervasive problems, including widespread poverty.

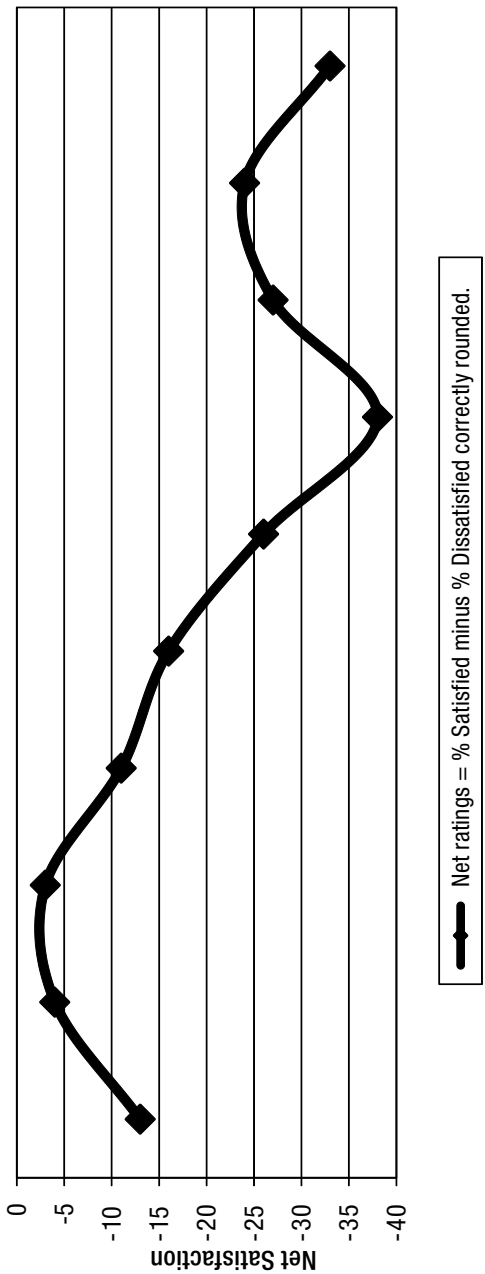
Notwithstanding the economic growth her administration had brought upon the country since assuming office in 2001, President Arroyo consistently suffered from negative net public satisfaction ratings even lower than her predecessors. During the year the rice price crisis erupted in 2008, the President's net satisfaction (i.e., the percentage of those satisfied minus the percentage of dissatisfied) reached –38, her lowest point ever (see Figure 9.6). The President got a dissatisfaction rating of almost 60 per cent according to Social Weather Stations (SWS), her lowest record to date and the lowest for any sitting president in the post-Marcos period. Indeed, looking at survey trend lines, dissatisfaction ratings for the President began to slide lower than the satisfaction ratings in 2004. But by late 2007 and early 2008 when the crisis began, the dissatisfaction ratings for the President reached its highest point (Figure 9.7).[8] In response to such a gloomy situation in 2008, the administration embarked on a media initiative that showcased testimonials in the mass media by so-called ordinary people and how they were able to "feel the progress and prosperity" that came to affect the entire country.[9] Such efforts were meant to reassure the public about the development achievements made by the political administration, but with little overall positive effect.[10]

MINDING THE GAP: THE STATE OF POVERTY IN THE PHILIPPINES

Crisis situations aggravate poverty. The Asian financial crisis in 1997/98 combined with the El Niño weather phenomenon and the spiralling growth in population, led to an increased poverty incidence in the Philippines from 36.8 per cent in 1997 to 37.5 per cent in 1998. Rural-urban poverty levels were also affected by that financial crisis. In 1994, there were twice as many rural poor households as there were urban poor. But by the time the crisis began in 1997, there were 2.4 times as many rural poor (ADB 2000, pp. 2–3).

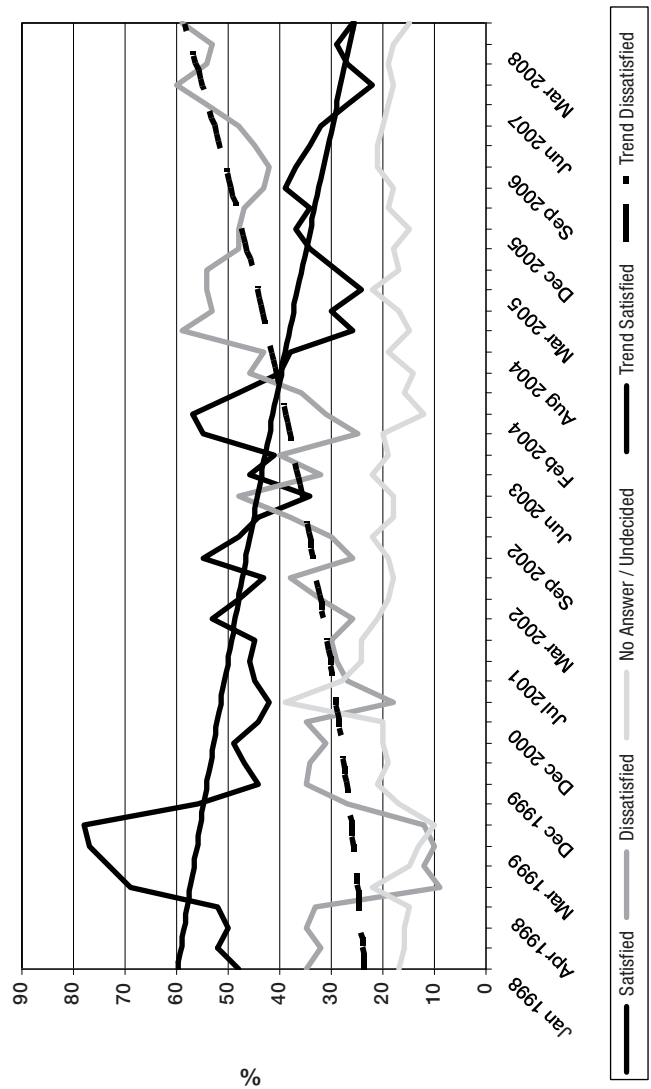
Any poverty alleviation programme relies heavily on estimates of poverty incidence. At the same time, poverty incidence is most often computed in the country in terms of identifying the poverty threshold — the minimum amount necessary for a family of five to live comfortably in any given day or month. The same applies to determining the food threshold — the

FIGURE 9.6
Net Satisfaction for President Arroyo, November 2006 to February 2009



Source: Social Weather Stations Media Release (16 March 2009) <http://www.sws.org.ph> (accessed March 2009).

FIGURE 9.7
Satisfaction/Dissatisfaction Ratings of Presidents, 1998–2008



Source: Social Weather Stations (2009*b*).

minimum amount necessary to allow a family of five to purchase an ideal food basket. Since 1987, the government has had to rely on its own poverty and food threshold measurement instruments, which have undergone several "refinements" since 1992.[11] The latest of such refinements were adopted by the government in February 2011 in which the issue of "comparability across time and space" was addressed. What this meant was that the methodology used in the latest poverty statistics (i.e., 2009) would also be applied retroactively, i.e., that the figures for previous estimates in 2006 and 2003 would now be using the "refined" methodology. The effect of this new method is that the monthly poverty threshold would now be 10–11 per cent lower while the food threshold would now be 7–8 per cent lower compared to the old computation. As a result, the poverty line would go down from 41 pesos per person per day to 37 pesos per person per day and invariably lead to reduced poverty incidence overall, as seen in Table 9.1.

Despite these "refinements" in poverty statistics and the prevalence and persistence of decades-long poverty-alleviation programmes, however, poverty levels in the Philippines have not really improved significantly.[12] The overall poverty incidence and subsistence incidence among Filipino families have remained flat since 2003, even with the latest statistical modifications.

The magnitude of poverty in 2006 was highest in the central Philippines (about 25 per cent of the national total), while Metro Manila (National Capital Region, or NCR) and the Cordillera Administrative Region (CAR) in the northern Philippines have the fewest number of poor families (Figure 9.8). Three of the ten poorest provinces in the country in terms of poverty incidence among families are still found in the Autonomous Region of Muslim Mindanao (ARMM) in the southern Philippines. Poverty levels continue to be widespread throughout the archipelago (see Figures 9.9 and 9.10). Also, hunger continues to be felt by a significant portion of the population. Regional food poverty figures appear to show minimal improvements across the country, especially in the central and southern Philippines.

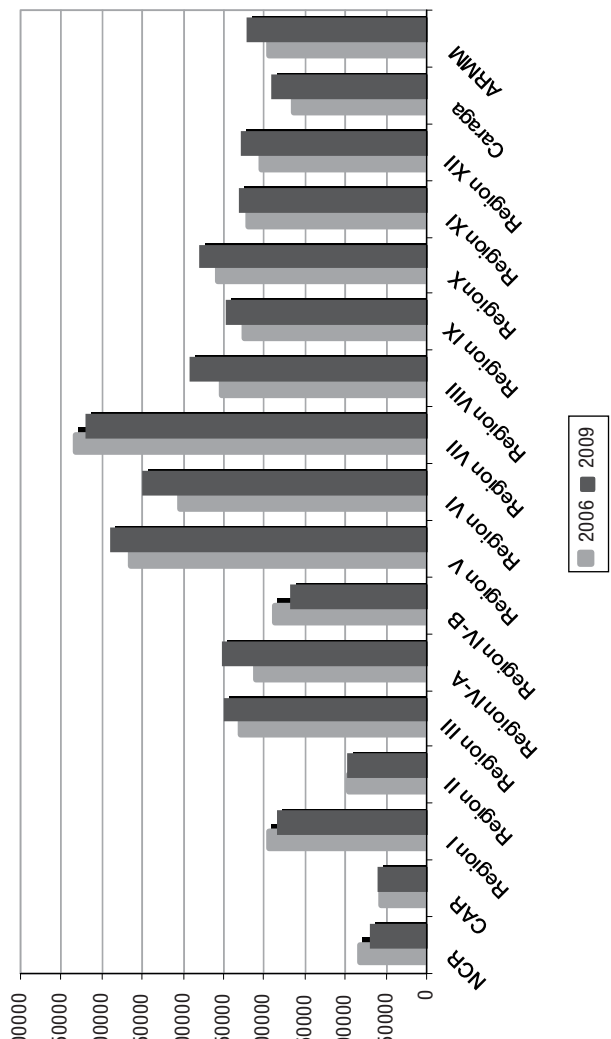
In addition to government poverty estimates, polling institutions have conducted self-rated poverty and hunger surveys which are consistently much higher than the government poverty statistical estimates. Between 1983, when SWS began to administer its own poverty surveys, and 2008, the proportion of those who said they were poor rarely went below half of those surveyed, as shown in Figure 9.12, with the average being 60 per cent for the entire period. In 2008, a little over half (or 53 per cent on average for the year)[13] of those surveyed by SWS rated themselves as poor, while about a quarter placed themselves on borderline poverty (SWS 2009*a*).[14] The magnitude of food

TABLE 9.1
Comparison of Poverty Estimates Based on Old and Refined Methodology, 2003, 2006 and 2009

	Old Methodology			*Refined*			*Difference*		
	2003	*2006*	*2009*	*2003*	*2006*	*2009*	*2003*	*2006*	*2009*
Among families									
Subsistence Incidence (%)	10.2	11	10.3	8.2	8.7	7.9	–2	–2.3	–2.4
Magnitude of Food Poor (million)	1.7	1.9	1.9	1.4	1.5	1.5	–17.6	-21.1	–21.1
Poverty Incidence (%)	24.4	26.9	26.3	20	21.1	20.9	–4.4	–5.8	–5.4
Magnitude of Poor (million)	4	4.7	4.9	3.3	3.7	3.9	–17.5	–21.3	–20.4
Among individuals									
Subsistence Incidence (%)	13.5	14.6	13.9	11.1	11.7	10.8	–2.4	–2.9	–3.1
Magnitude of Food Poor (million)	10.8	12.2	12.2	8.8	9.9	9.4	–18.5	–18.9	–23
Poverty Incidence (%)	30	32.9	32.6	24.9	26.4	26.5	–5.1	–6.5	–6.1
Magnitude of Poor (million)	23.8	27.6	28.5	19.8	22.2	23.1	–16.8	–19.6	–18.9

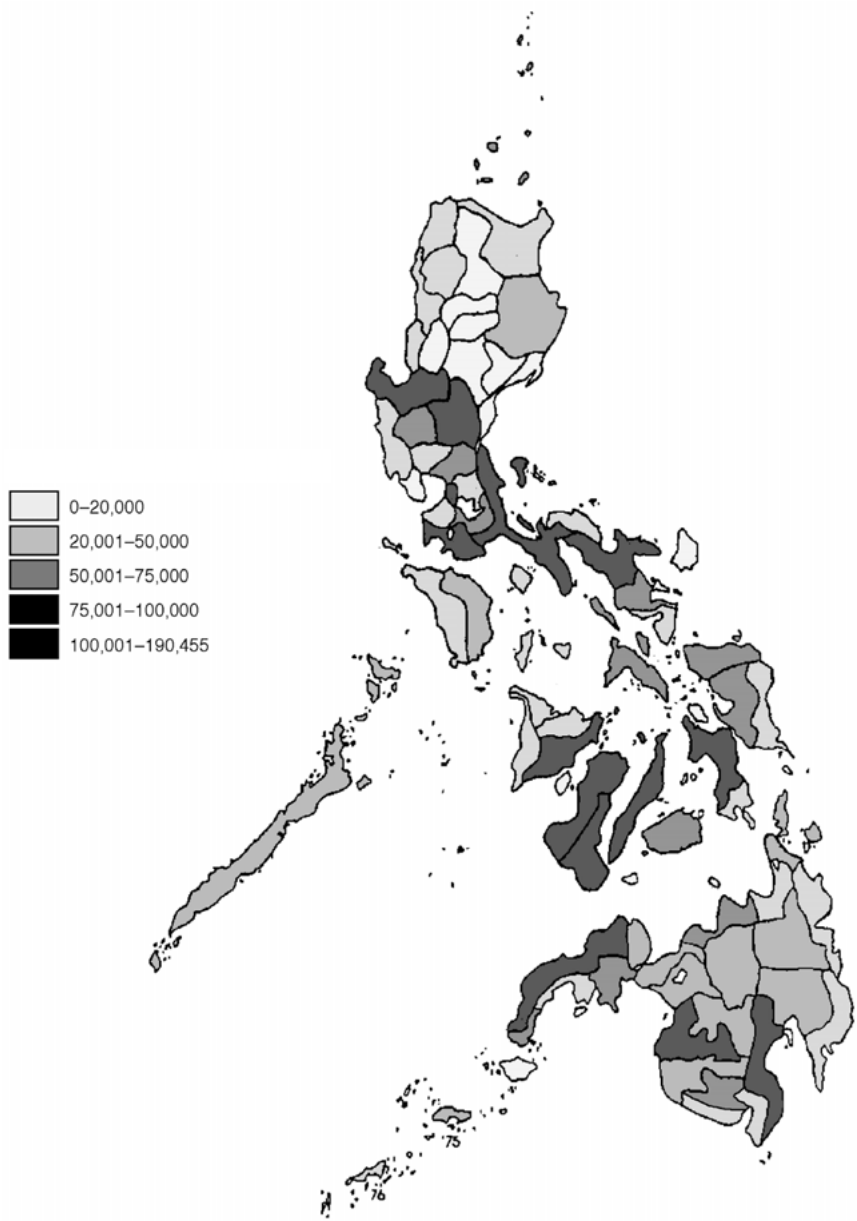
Source: Virola (2011), Table 1.

FIGURE 9.8
Magnitude of Poor Families, 2006 and 2009



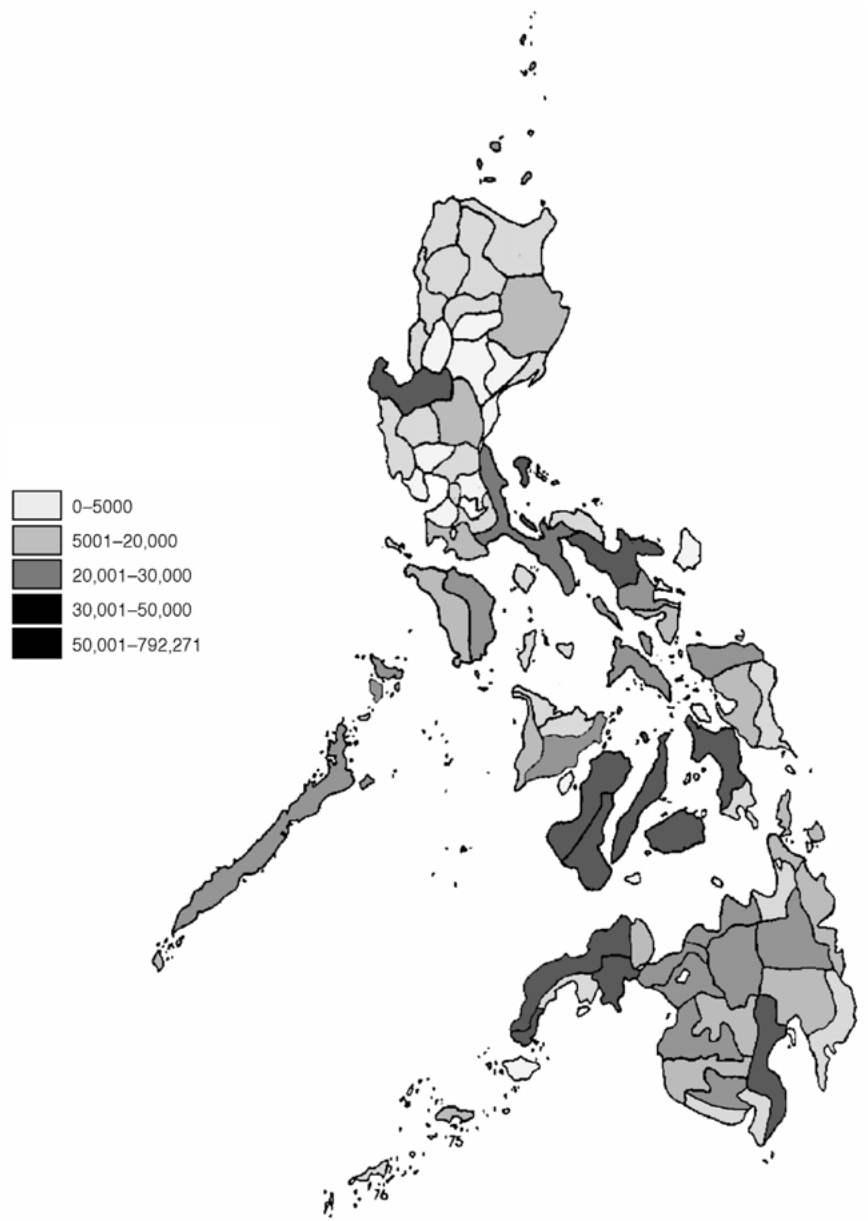
Source: National Statistical Coordination Board (2011), Table 5.

FIGURE 9.9
2006 Magnitude of Poor Families



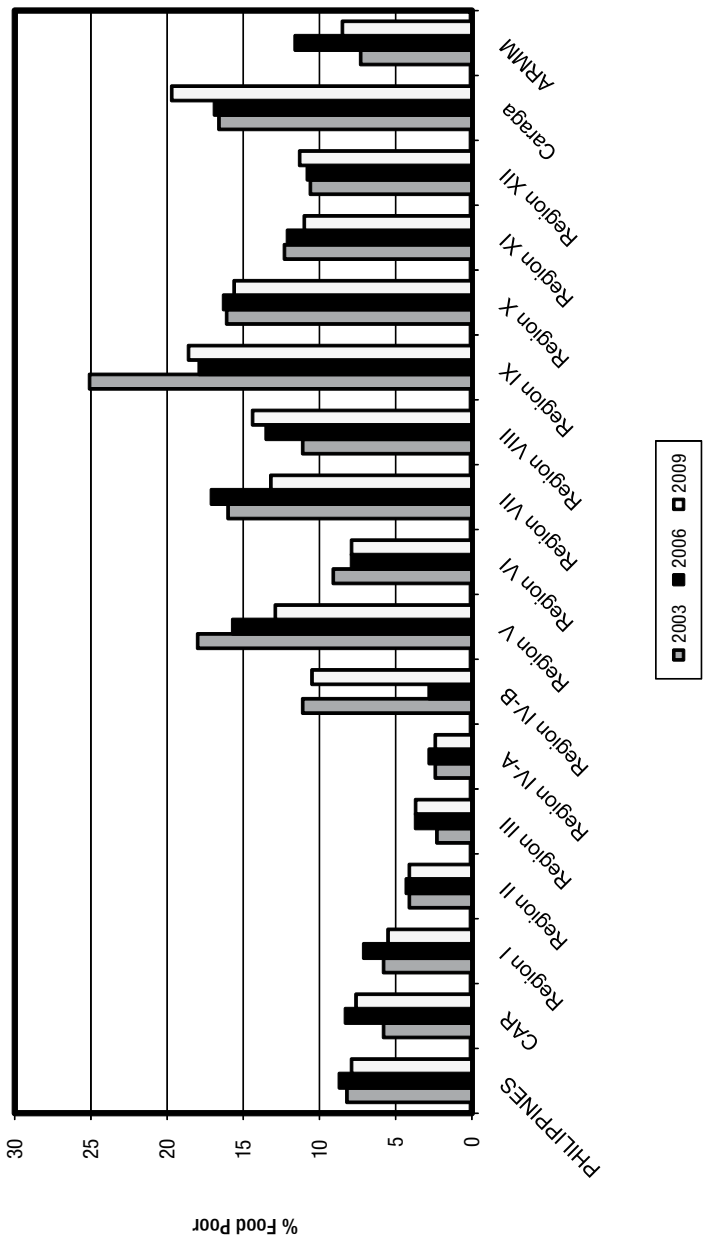
Source: NSCB (2011), reproduced with permission.

FIGURE 9.10
2006 Magnitude of Subsistence Poor Families



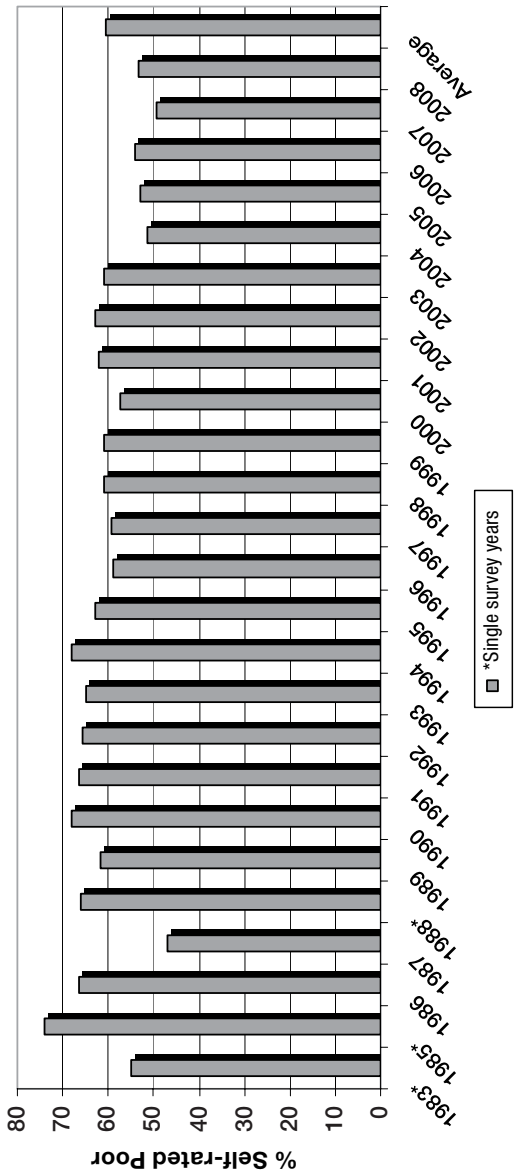
Source: NSCB (2011), reproduced with permission.

FIGURE 9.11
Food Poverty Estimates by Region, 2003, 2006, and 2009



Source: NSCB (2011), Table 3.

FIGURE 9.12
Self-rated Poor, 1983–2008



Source: Social Weather Stations (2009*a*).

poverty incidence in the country[15] has also been at serious levels. SWS surveys on food poverty between 2000 and 2008 show that food poverty ratings have not gone below 42 per cent, with the average for the period at over 47 per cent (Figure 9.13). The statistical evidence also shows that, historically over nearly three decades, there have been no significant improvements in either self-rated poverty or self-rated food-poor levels.

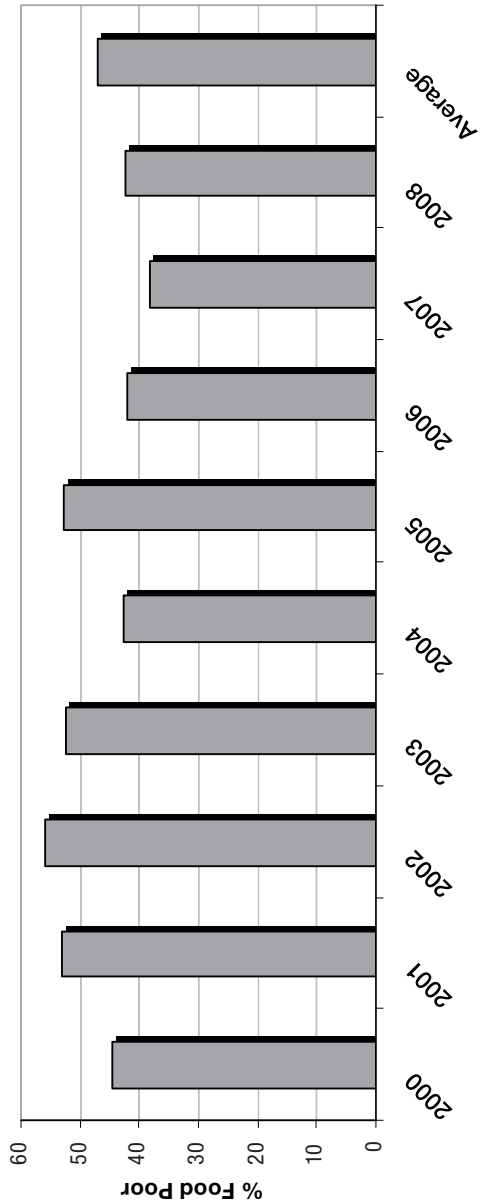
The total number of Filipinos who fall below both the poverty and food-poverty threshold has not diminished significantly over the years. A World Bank discussion paper noted in the late 1990s that "compared with other countries in the region, the Philippines' long-term poverty record is disappointing" (Subbarao et al. 1996, p. 4). Philippine poverty is largely rural poverty which has affected over half of the country's farming households since the 1980s (Schelzig 2008, p. 98). Poverty among farming households is said to be three times higher than poverty incidence in other sectors, while estimates in 2006 indicate that three out of four poor Filipinos live in rural areas and that rural poverty had in fact increased from 12.1 per cent in 2003 to 14.4 per cent in 2006 (World Bank 2008, p. 15).

THE POOR AND RICE PRICE SUBSIDIES

Rice is a major staple and food source for many Filipino families nationwide. However, rice is actually more than a mere staple food grain and is considered to be "4 % protein and 96 % politics" (Dobbs 2000, p. A24). Because it is an essential component of any Asian diet and culture, rice is always (to a significant degree more than any other food crop) also politicized, especially when it involves the poor (Intal and Garcia 2005, p. 13). The political nature of rice is also underscored by the fact that it is a primary food source for the poor. It contributes substantially to any family's calorie intake. The poorest households are said to rely on rice for as much as 60–65 per cent of their calorie intake (David and Balisacan 1995, p. 1).

Food and rice expenditures in general make up a substantial portion of the expenditures of Filipino families. Poorer families actually spend proportionally more on food than those families belonging to the upper income quintiles. The World Bank (2008, pp. 26, 34, and 36) found that the households in the lowest quintile spent nearly two-thirds of their income on food; almost twice as much as those belonging to the highest quintile (about 33 per cent). Furthermore, the lowest quintile spent about 18 per cent of their consumption for rice, in contrast to only about 4 per cent among the highest quintile. On the other hand, the poor spent only about 1.4 per cent for health and 1.7 per cent for

FIGURE 9.13
Self-rated Food Poor, 2000–2008



Source: Social Weather Stations (2009*a*).

education, while the average household spends nearly twice that proportion for health and about three times as much on education (World Bank 2008, p. 36). These percentages mean that poor households are more likely to be trapped in the vicious poverty cycle because they are less likely than those belonging to the upper income quintiles to make significant investments in their own human capital formation and development through higher health and education expenditures. Jha and Mehta (2008) also arrived at the same conclusion based on their own calculations — poor households actually spend proportionally more on rice than households that are relatively better off. According to their calculations using 2006 FIES (Family Income and Expenditure Survey) data, poor families who belong to the bottom quintiles spend anywhere from one-quarter to one-third of their food expenditures on rice in both rural and urban settings. The share of purchased rice to actual consumed rice is also lower for the bottom quintiles, suggesting that they may be relying more on other sources of rice for consumption, such as welfare handouts from non-governmental organizations or from the government. In rural areas there is also some rice grown for households' own use, which explains why the amount of rice purchased is less than the rice that is consumed.

Given their predicament, the poor are more likely to be affected by upward movements in retail rice prices. For poor households "any increase in rice price means less money for other needs, such as health care and children's education" (Hossain 2005, p. 37). The poor are especially vulnerable to food price shocks, particularly when it comes to rice. This is where protein politics comes in. When rice is no longer affordable to the poor, it aggravates the poverty situation. The government may deem it necessary to make rice available to the poor in order to reduce their misery and also as part of its overall poverty-alleviation strategy. This kind of policy to provide rice price subsidies to the poor can provide an invaluable option to assist those faced with skyrocketing food prices. Providing price subsidized food frees up income for other uses, thereby improving household purchasing power, which is of immense value when inflation is high (Jha and Mehta 2008, p. 1). However, since rice is also a political commodity, providing rice subsidies to the poor can also "buy" their political allegiance and support. Rice price subsidies can thus become politically beneficial to politicians and can also lead to a situation where the government is able to gain the active support of the poor (or at least their acquiescence). Keeping the market price of rice at a low and affordable (i.e., subsidized) rate has thus become a political imperative for any incumbent administration.

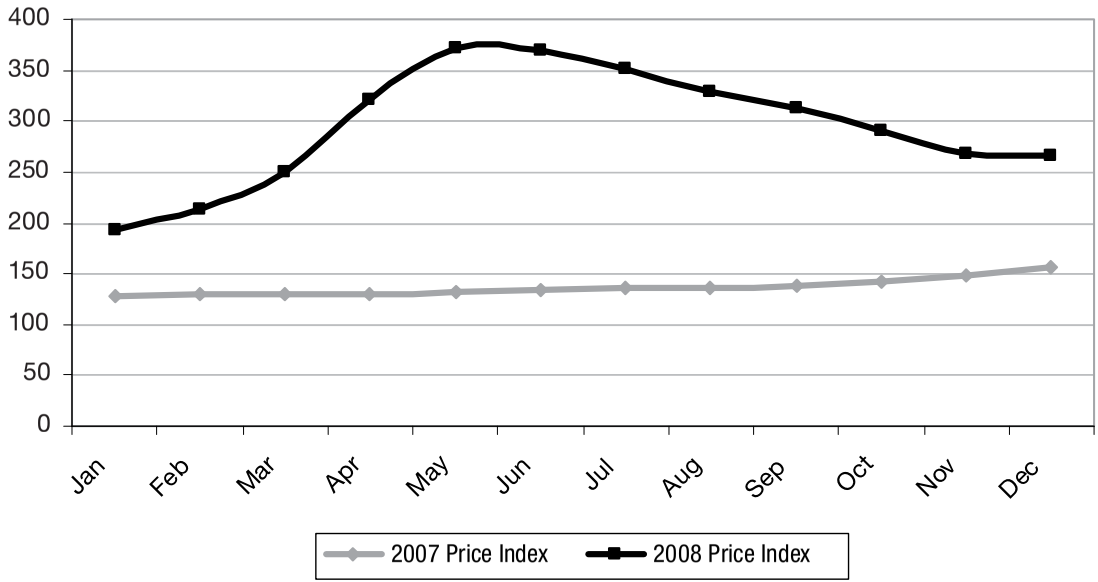
Such a policy response would require continued as well as financially costly levels of public expenditures. Through the years, the National Food Authority (NFA) has become the principal government agency that has undertaken such a policy response. It is the government agency mandated to intervene in the market by providing domestic price stability for (and affordability of) rice for the poor. Historically, rice subsidies have been an integral part of any political administration in the Philippines. During the time of the Estrada administration, "the NFA's rice distribution function was also made part of the government's Lingap Para sa Mahihirap [Care for the Poor] Program, which seeks to provide comprehensive support to the 100 poorest households in each province and city" (World Bank 2001, p. 104). In 2006, the NFA supervised and coordinated the operation of 224 rolling stores (of which 134 were NFA-operated while the rest were privately operated) (NFA 2006, p. 5).

There is a difference between rice that is commercially available and government rice. The government sells rice at fixed and subsidized rates (around 18 pesos per kilo in 2008) through the NFA. Commercial rice is rice that is sold at prevailing market prices. The price of commercial rice in the local market is largely dependent on the price of rice in the global market, which can be fickle at times but stable overall. The rice price index was relatively stable in 2007. However, in 2008 the world rice price index doubled from 157 in January to 372 by May of that year (Figure 9.14). Although by the end of 2008 the index had "stabilized" to 265, it was still high compared to the previous ten years' average of just 100.[16] Being highly dependent on imported rice, the radical increase in the world price index deeply affected the market price of rice in the Philippines, where the price of commercial rice increased by 33 per cent in four months even though the increase in the previous year was less than 5 per cent (Figure 9.15).

As a result, the political administration had to act in a manner that would offset the adverse effects of this rice price crisis on the poor. In April 2008 the Department of Social Welfare and Development (DSWD) was ordered to identify the poorest households in Metro Manila and to make rice available to them at subsidized prices.[17] The poorest households are said to be "30 percent of the population's bottom poor families" (DSWD 2008). The department identifies the poorest households in coordination with the *barangay* (village) councils based on a monthly income not exceeding 5,000 pesos a month (DSWD 2008).

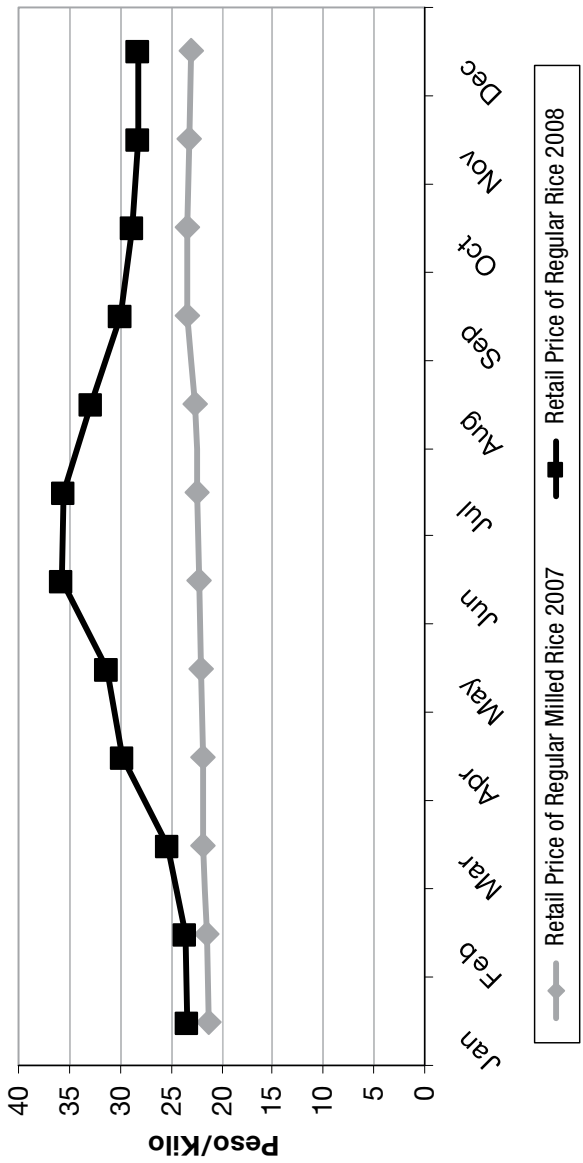
In the following month, the government unveiled its food security "master plan" for attaining 100 per cent self-sufficiency in rice by 2013

FIGURE 9.14
World Rice Price Index, 2007 and 2008



Source: Food and Agriculture Organization (2009*b*).

FIGURE 9.15
Retail Price of Regular Rice, 2007 and 2008



Source: Bureau of Agricultural Statistics (2009*b*).

(Roque 2008; FAO 2009), making it less dependent on imported rice and allowing more Filipinos to have sufficient access to affordable rice. Its aim was to increase total palay production and raise farming income in order to reduce the country's huge dependence on rice imports (DAR 2008, p. 7). The plan called for the participation of provincial government officials as "rice champions", where each province is provided a support fund as well as other incentives if they are able to exceed their rice production targets. The plan had a budget for two years of around 30 billion pesos which included the "budget for the rehabilitation of irrigation systems and continuing rice R&D" (DAR 2008, p. 9).

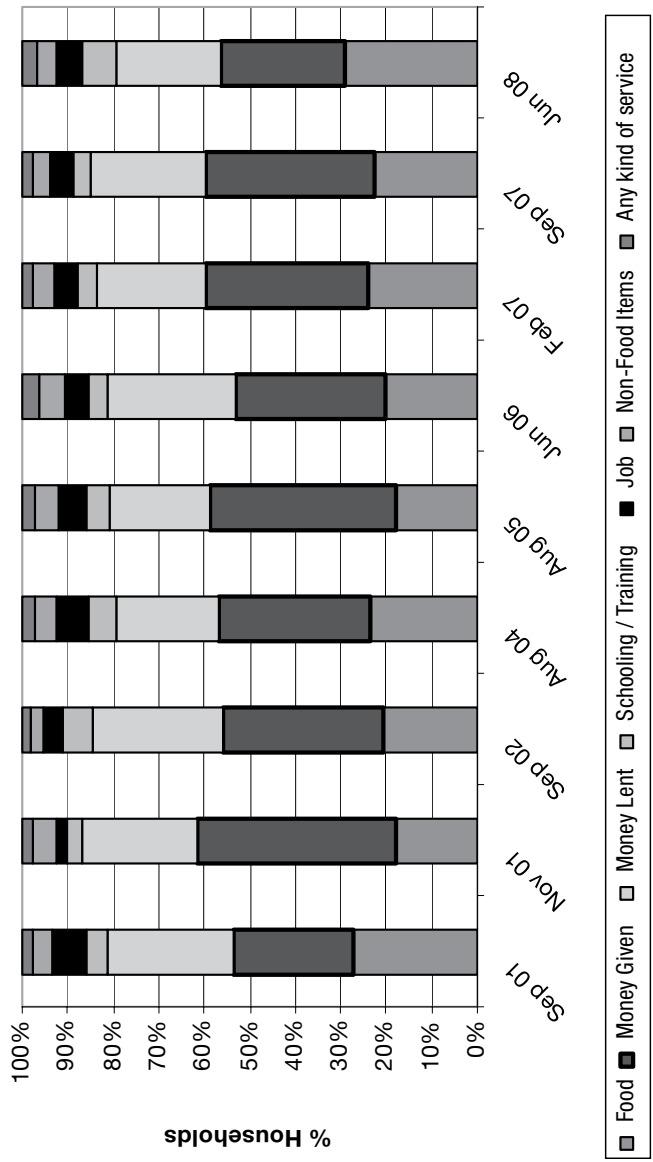
By July 2008, the NFA was selling subsidized rice at 18.25 pesos per kilo for the poor through their mobile stores and other selected community outlets. At the same time, the NFA was making available commercial rice at 25 pesos and 35 pesos per kilo for middle- and high-income households to help stabilize the commercial price of rice at the 35 pesos per kilo level (FAO 2009). In addition to its subsidized rice programme, the government also initiated a cash transfer programme involving families with children of schooling age, called the Pantawid Pamilyang Pilipino Programme (4Ps), or Support Programme for the Filipino Family, administered by the DSWD to ensure that children of schooling age continued attending school and were guaranteed adequate nutritional intake.

The SWS noted in its June 2008 survey that the most common form of help that respondents got was food. According to SWS, this was the first time that food became the most common form of help received by their survey respondents since 2001 when they started asking the item (SWS 2008) (Figure 9.16).[18] About a third of the respondents in 2008 said they received help from the government and that nearly half (45 per cent) of those got their assistance in the form of food subsidies. The question now is do these rice subsidies actually empower the poor or do they make them more dependent on power-holders?

GOVERNMENT AS RICE DISTRIBUTOR: A STRANGE BEDFELLOW?

Historically, the government has been extremely sensitive to any crisis affecting the supply and consumption of rice. Any sudden price increases in this commodity would have significant adverse effects on a substantial portion of the electorate, namely the poor. This was the primary justification for the creation of the National Rice and Corn Corporation (NARIC),

FIGURE 9.16
Forms of Help Received in the Past Three Months, 2001–08



Source: Social Weather Stations (2008), Table 1.

the predecessor of the NFA, in 1936. Poor harvests due to bad weather led to a 20 per cent reduction in rice production and caused rice prices to increase by 25 per cent in 1935 and another 25 per cent the following year. The rice crisis of that period forced the government to start importing rice and to establish NARIC as a means for providing popular price stability for rice by protecting it from further rapid upward market shifts (Intal and Garcia 2005 and Intal and Powers 1990).

By the 1960s, NARIC was reorganized into the Rice and Corn Administration (RCA) with a declared policy "to stabilize the price of palay (unhusked rice), rice, and corn … [and] sell and dispose of these commodities to the consumers … *at a price that is within their reach*" (Section 1 of RA 3452; emphasis added). By the early 1970s, RCA became the National Grains Authority (NGA), "an institution conscious of its *social responsibilities* and capable of providing adequate and continuous food supply to the nation and of contributing to its proper share to [the] national economy" (Section 2, PD No. 4; emphasis added). Strongly implied in the creation of the agency was its pro-poor mandate, because it had been tasked to determine the floor price for grains that would ensure fair returns to the farmer/producer and procure or maintain grain stock so as to ensure the floor price (Section 5bv, PD No. 4).

In 1981, the NGA was renamed the National Food Authority (NFA) by virtue of another presidential decree, as a government corporation attached to the Department of Agriculture. While its mandate covers the entire food industry,[19] in practice the NFA has been largely involved in rice supply and price stabilization activities. It does this by making sure there is an adequate supply of commercial rice and government subsidized rice in order to make up for any sudden increase in market price due to imbalances in supply and demand (World Bank 2001, p. 103).

RICE AS PROTEIN POLITICS

Historically, the essential socio-political function of the NARIC/RCA/NGA/NFA has been mainly in the area of stabilizing the market price of rice (Intal and Garcia 2005) by making rice cheaply available to the poor without disturbing the interests of the producers (i.e., rice farmers) who want to sell their produce at the highest price possible. It is simply summed up in the following principle: "buy high (from farmers), sell low (to consumers) and store long (to stabilize prices)" (Tolentino 2002, p. 2). Such a principle

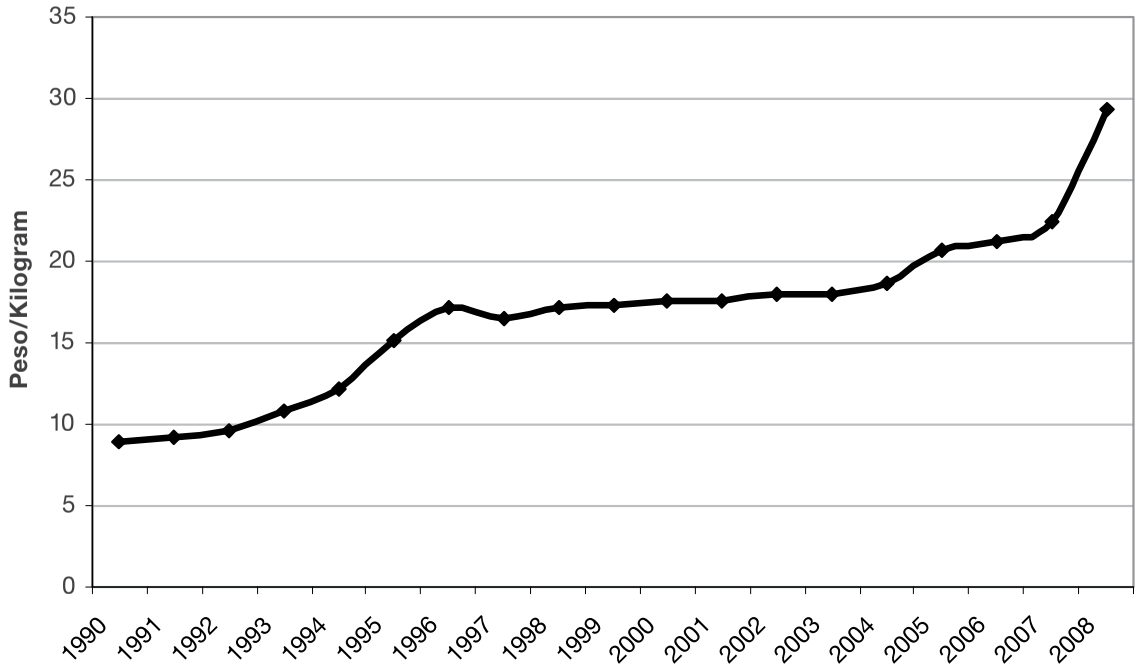
obviously goes against common market tenets. The NFA guiding principle does not make much market sense precisely because it is essentially dictated by political motives.

Political administrations are likely to be troubled by long queues of people wanting to buy rice. It is bad enough if this essential commodity becomes less and less available raising its price in the market. It would certainly lead to the significant erosion of trust and confidence in the political incumbents involved. In other polities, riots have erupted due to the unavailability of such a precious and essential commodity as rice. It may also be the case that the incumbent administration would want to "buy off" the support of the people by allowing for the greater availability of cheaper rice in politically sensitive markets.

Rice is always an election issue in the Philippines. It has been used by politicians in the Philippines as a means to win votes and rally support. It would not be in the electoral interest of the incumbent if a rice shortage or rice price surge were to occur, especially in an election year as it can endanger an incumbent's re-election chances as well as increase the likelihood of the challenger's victory. The incumbent administration can use its agencies to control the supply, distribution, and even the market price of rice to gain electoral support or even acquiescence, especially from the large poor population. However, political opposition groups would want to capitalize on the recurrence of rice shortages to drum up support for their candidates and discredit the administration. Such has been a characteristic feature of the country's electoral history since the Commonwealth period of the 1930s (Tadem 1986).

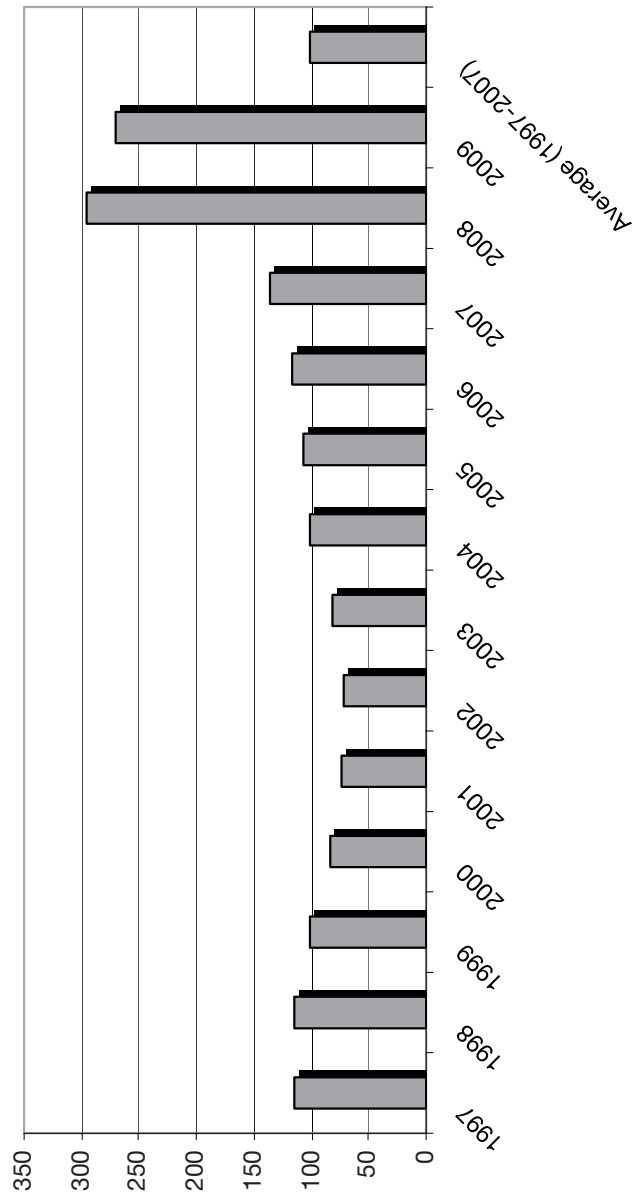
Intal and Garcia (2005) have observed that, from the 1950s to the 1960s, the domestic price of rice would go up just before a presidential election. Such an upward surge in rice prices would translate into popular discontent with the incumbent leadership and would thus endanger one's bid for re-election. The rice crisis of 2008 may have been the worst price crisis for the country, but it is not the first. Between 1990 and 2007 there has been one significant upward surge in the retail price of regular rice which happened from 1994 to 1996 as can be seen in Figure 9.17. The domestic price of rice in the Philippines is also affected by the global rice market. Trading prices in the world market for rice tripled between 2007 and 2008 (Figure 9.18). Interestingly, the sudden price increase "was not due to poor harvests, an increase in demand, or a tight global supply situation", because "global rice production in 2007/08 was the highest on record" at over 433 million tonnes (Childs and Kiwau 2009, p. 4).

FIGURE 9.17
Annual Retail Price of Regular Milled Rice, 1990–2008



Source: Bureau of Agricultural Statistics (2009*c*).

FIGURE 9.18
Annual World Rice Price Index, 1997–2009



Source: Food and Agriculture Organization (2009*b*).

There is some reason to believe that the increase occurred due to the significant rice imports made by the NFA at the time. Considering the fact that the Philippines is the single largest rice importer in the world, the large quantity of rice imports made by the country in that year may have driven rice producers in other countries (particularly Thailand and Vietnam) to sell their stocks exclusively to the Philippines knowing that the government would buy their inventory at whatever price. However, comparing historical data on Philippine rice imports with the world rice price index, it would seem that the increase in the index is not a major function of Philippine rice imports (Figure 9.19).

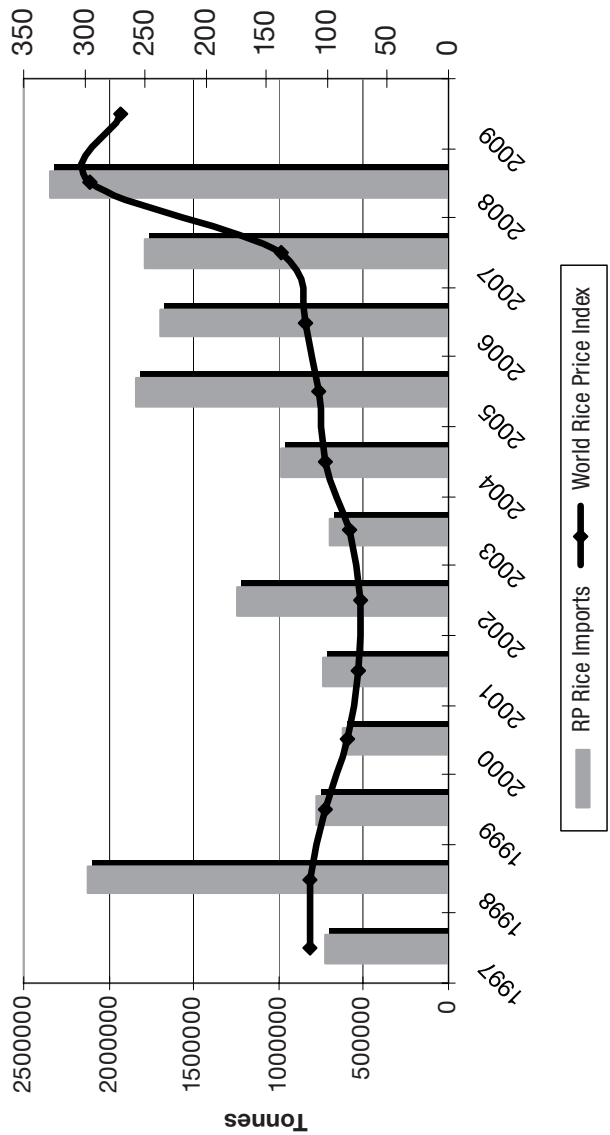
Childs and Kiawu (2009) cite numerous short- and long-term factors that account for the upsurge in the world price of rice. Commercial export restrictions implemented by major rice-producing countries like Vietnam (the second-largest rice-exporting country in the world), India, Cambodia, and Myanmar beginning in late 2007 created a condition for world market rice prices to surge upwards. Vietnam and India had become concerned about their own exports that would have resulted in reducing their respective domestic rice supplies to levels deemed low. "By banning or restricting rice exports, the governments [in these countries] were making more rice available for the domestic market in an attempt to stabilize domestic food prices and limit overall inflation rates" (Childs and Kuwai 2009, p. 8).

Meanwhile, severe weather problems affected the other rice-producing areas. Myanmar's rice fields experienced severe damage due to cyclone Nargis. Weather disturbances experienced in late 2007 and early 2008 raised concerns among rice producers about the possibility that their coming rice harvests would be severely reduced. By the second quarter of 2008, only Thailand and the United States among the major rice-exporters of the world had not imposed rice trade restrictions. This situation had adversely affected about 40 per cent of global rice exports (Childs and Kuwai 2009, pp. 7–8).

Panic-stricken, the major rice-importing countries such as Indonesia, Bangladesh and, most notably, the Philippines, attempted to stave off the impending increase in rice prices by quickly increasing their stocks through higher import purchases over a shorter period and reduction of import tariffs. This situation did not do much to ease the rice price upsurge globally as rice-importers would typically spread their purchases evenly throughout the year in order to minimize any impacts on global prices (Santo Domingo 2008; Childs and Kuwai 2009, p. 10).

The Philippine response to the global rice price crisis is one that can be seen to be typical for a poor country. The bigger the perceived threat of a

FIGURE 9.19
Philippines Rice Imports and World Rice Price Index, 1997–2009



Source: Food and Agriculture Organization (2009*b*), National Food Authority (2008), and International Rice Research Institute (2008).

price increase, the greater the quantity of rice imported would be in order to offset any domestic price instabilities that can eventually lead (as it did to some extent in the Philippines) to a crisis of political stability. Invariably, rice consumers receive much attention from development policy executives.

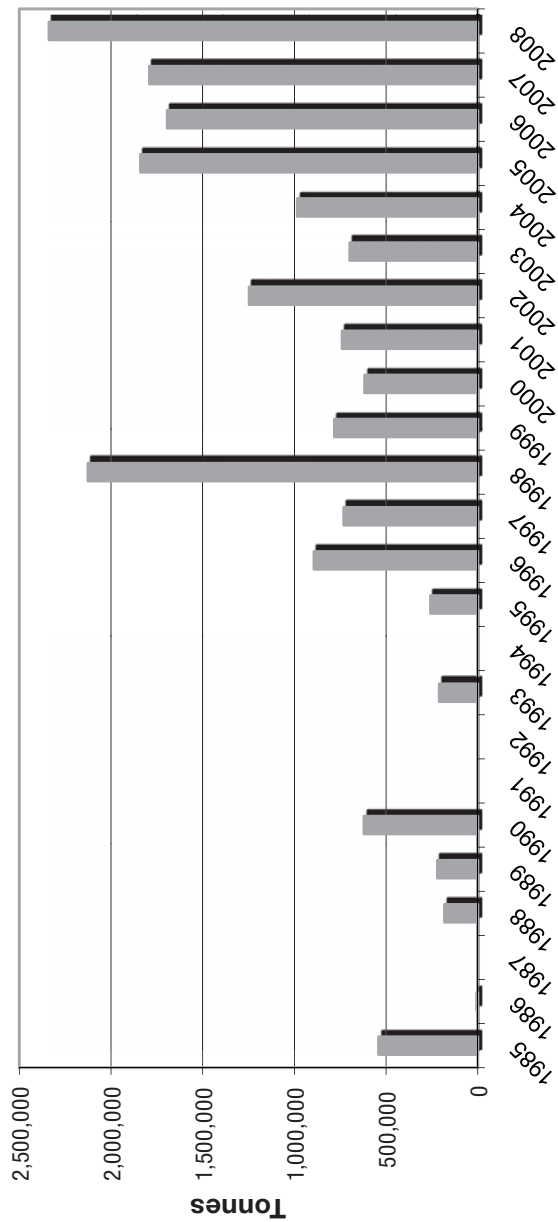
Yet poverty in the rice-farming sector is still widespread (Casiwan et al. 2006) and it is not uncommon for rice farmers to augment their incomes from non-farm sources, including migration (Cabiling and Dawe 2006). Since most of them are share-croppers and small landowners, Filipino rice farmers are typically at the mercy of landlords, millers, and rice traders (Intal and Garcia 2005, p. 9). The government purchases only a small percentage of its rice stocks from domestic producers. The bulk of the government's rice stock (over 95 per cent) is imported (Jha and Mehta 2008, p. 4) while the rest is produced domestically (Del Mundo 2008 and Yao et al. 2007).

Faced with such a situation, the unique response of the government is to manage the rice price crisis in a way that suits both producers and consumers, i.e., to make rice affordable to consumers (by way of imports) while at the same time allowing for adequate remuneration to domestic producers (by way of subsidized rice purchases) (Intal and Garcia 2005, p. 13). Hence, it is not surprising that the largest rice import years were also the years incumbent political administrations faced serious electoral and political challenges (Figure 9.20).

Notwithstanding other natural and man-made factors, substantial rice imports have been a common feature for any administration since the 1990s to respond to declining rice stocks. Anticipating that retail prices in 1998 would increase due to a shortfall in domestic production relative to consumption demand, the government imported the largest quantity of rice (2.1 million tonnes) to date.[20] In the midst of persistent campaigns to oust her since 2001, President Arroyo has imported significant quantities of rice from a "low" of 697,000 tonnes in 2003 to the highest the country has ever achieved (2.3 million tonnes in 2008).[21]

Rice importation could very well be a reliable barometer of the level of populist threat and opposition being perceived by any political administration. This may be indicated by the extent to which rice subsidies have been historically distributed in large metropolitan centres that do not exhibit significant poverty levels. From 1991 to 1993, Metro Manila received the highest regional share of NFA rice (22 per cent) despite the fact that it had a low food poverty magnitude relative to other regions in the country that were experiencing more serious levels of food insecurity (Subbarao et al. 1996, p. 18).[22] One cannot help but think that the primary consideration

FIGURE 9.20
NFA Rice Import Arrivals, 1985–2008



Source: National Food Authority (2008).

for targeting the poor in Metro Manila is more to be able to win the political support of people for the government and less to significantly and effectively address poverty.

Opinion surveys in the Philippines show that helping the poor is a major concern for the government but, unfortunately, one that is seen with ambivalence by the public. The SWS in December 2007 showed that the number of those satisfied with what the national government was doing to help the poor (45 per cent) was almost the same as those who were dissatisfied (41 per cent), although in the area of addressing the hunger problem there were much more respondents who were dissatisfied (50 per cent) than those who were satisfied (28 per cent) with what the national government was doing.

POLICY CRITIQUE

These rice subsidies come with a price. In implementing its mandate of providing price stability, the NFA has become the biggest consistent financial loser among all government corporations (Jha and Mehta 2008, p. 4). In 2006, the NFA reported a gross loss for the year of 9.6 billion pesos. During the previous year, it reported a loss of 12.2 billion pesos, while its net operations loss in 2005 and 2006 amounted to 15.5 billion pesos and 13.2 billion pesos respectively (NFA 2006, p. 19). These losses incurred by the NFA are largely due to its substantial rice imports that account for 99.8 per cent of its total annual losses and the fact that it sells the rice at prices below prevailing market rates (NFA 2006, p. 19).

In 2008 the NFA was given 60 billion pesos for rice importation (much of which went to tariff payments and duties) and another 15.7 billion pesos for local rice procurement (Rimando 2008*b*). None of these were ever recovered. In fact, in order to continue selling rice at subsidized rates (i.e., between 18.25 pesos and 25 pesos per kilo), the NFA incurred a loss of 18.5 billion pesos for imported rice and 2.5 billion pesos for locally procured rice on top of the original allocations (Business World 2008).

The NFA also continues to incur high operations costs. These costs have been so substantial to the point that the subsidy the agency got from the national government is not enough to allow it to operate efficiently and effectively. Assuming zero leakage or diversion to the non-poor of such subsidized stocks, for instance, the NFA spends around US$2 for every US$1 it transfers as food subsidy to rice consumers. It has been observed that the NFA "delivered one peso of income to a consumer at a cost of P2.99 in

1991 and P2.15 in 1992" (Subbarao et al. 1996, p. 15). However, the actual transfer cost for the NFA may go as high as US$4 if, as Jha and Mehta (2008) and Subbarao et al. (1996) assume, the average leakage rate for other Asian countries, which ranges from 50 to 70 per cent, applies. In fiscal year 2009, the NFA received the largest subsidy from the national government relative to all government corporations according to the Department of Budget and Management (DBM). The NFA rice subsidy programme cost the national government around 167 billion pesos in 2008, which is 2.5 per cent of the country's gross domestic product for that year (Jha and Mehta 2008, p. 5).

Given its inclination to engage in high rates of rice importation, the NFA's outstanding debt in 2008 reached 108 billion pesos, or more than twice the amount recorded in the previous year (around 43 billion pesos). This is due mainly to its purchase of rice in the world market at significantly raised prices.[23] From an originally anticipated US$795 per tonne, the actual cost of imported rice went as high as US$1,000 per tonne in early 2008 and eventually settled at US$900 per tonne (Remo 2008) by the middle of the same year.

The NFA sets the guidelines for the private sector to import commercially available rice even as it also imports its own rice stocks. Ideally this would allow the agency to shield local rice farmers and ensure the profitability of domestic rice farming while at the same time ensuring that low-priced rice reaches the consumers. The agency does this by buying rice from local farmers around 9 per cent higher than the prevailing procurement price for commercial rice (Jha and Mehta 2008, p. 4). However, considering the fact that only a small portion of domestic production is actually bought by the NFA, it is doubtful that its purchases will have much impact on the market price of commercially available rice in the country. The NFA must still make sure rice continues to be affordable to rice consumers by selling its own stocks at lower and subsidized rates. Under ordinary circumstances, "the retail price of NFA rice to consumers is generally set at about PhP4.00 per kilo lower than the prevailing market price for rice", or about 18 per cent cheaper than commercially available rice (World Bank 2001, p. 104; Jha and Mehta 2008, p. 4).

However, the market pricing mechanism for rice affects producers and consumers in opposite directions. Producers benefit when the market price is high while consumers (particularly the poor ones) suffer; but when the market price is low, the benefits move in the opposite direction. This is where the government steps in to absorb (or subsidize) the cost difference between production and consumption at substantial financial costs.

Still, the NFA sees no reason to worry in the face of its financial predicament. All its debt obligations have the sovereign guarantee of the national government. By providing such sovereign guarantees, however, the overall financial liability of the national government is increased, especially towards financial institutions, not to mention the impact on the total debt payment burden (Tolentino 2002, p. 5). This kind of irresponsible fiscal policy attitude has the effect of passing the burden to the succeeding political administration without addressing the first-order question of how to effectively address the poverty situation.

Given the political significance of generating financing for a rice subsidizing agency like the NFA, it is not surprising to note that, in addition to the representative of the Office of the President, the other members of its governing council are the heads of government-controlled financial entities such as the Governor of the Central Bank (Bangko Sentral ng Pilipinas, or BSP), the Chairperson of the Development Bank of the Philippines (DBP), the Presidents of the Land Bank of the Philippines (LBP) and the Philippine National Bank (PNB), as well as the Secretaries of the Departments of Finance (DOF) and Trade and Industry (DTI).

Any increase in the income of the poor through such subsidies would only result in a negligible increase in their overall food consumption. For instance, the nearly 1 per cent increase in the income of the poor in 1992 "resulted in a 0.5 percent increase in food consumption and 0.3 percent increase in caloric intake" (Subbarao et al. 1996, p. 18). If the government were to stop granting these rice subsidies, such an action would only have a minimal adverse effect on its anti-poverty campaign but, at the same time, would lead to tremendous savings in government expenditures amounting to some 3 billion pesos annually (Subbarao et al. 1996, p. 18).

Aggravating the rice price crisis of 2008 were reports in the media of collusion between unscrupulous rice traders and NFA officials (Cabacungan and Señase 2008; Araneta 2008) in which rice from government stocks intended for the poor was diverted to the commercial market. Another example of an irregular practice is when commercial rice sellers switch or re-bag poor grade rice unfit for human consumption with or into high-grade imported rice. In this case, the NFA is made to pass off the poor quality rice as government subsidized stocks and absorb the social and financial costs attendant to such an activity while the commercial rice seller stands to earn tremendous profits (Romero and Cervantes 2008). Another anomalous practice is when corrupt NFA officials approve excessive releases of imported rice to private rice traders for a fee (Araneta 2008). Edno Joson, a former administrator of the NFA, said that as much as 2 billion

pesos (US$41.6 million) of taxpayers' money was lost when it sold the rice it had imported to local traders at a loss (Diaz 2008; Del Mundo 2008). Around 7.2 million bags of rice were imported by the government at a cost of 8.8 billion pesos, but the agency sold it to the private sector for only 6.7 billion pesos, resulting in a gross loss of around 2.1 billion pesos. A prominent opposition senator even decried "the rampant practice of corrupt NFA officials to divert the agency's rice stocks to grains cartels" (Philippine Senate 2008). No less than President Arroyo herself took note of the agency's efforts to "prudently and strictly manage the distribution of the national rice stock, the subsidized rice stock, and the NFA has begun by putting its own house in order" (Guinto 2008).

Intal and Garcia (2005) have observed that the rice crisis is actually a price crisis brought about by the semi-monopsonistic and cartel power of commercial rice traders in the country. Historically, the multi-billion-peso rice industry in the Philippines has been dominated and controlled by a cartel of merchants whose existence has been confirmed by numerous government officials even as none of them have actually been brought to justice (Gamolo 2008). It has been observed that the power of rice traders in the country "extends not only in controlling inputs and processing activities but also to the market price of rice" (Intal and Garcia 2005, p. 12). The cartel allegedly controls Dagupan Street in Metro Manila which is said to "supply 45 percent of the total rice needs of Metro Manila" or about 22 per cent of the city's daily rice consumption (Gamolo 2008).

Large-scale and commercial rice traders are able to artificially raise and reduce the buying and selling price of rice in the open market. They do this by hoarding or by flooding the market with their stocks.[24] Given the limited resources and support they receive (e.g., poor irrigation facilities, limited access to low-interest credit, among others), rice farmers are constrained either to sell their harvest at low prices or switch to other crops or convert their fields entirely for residential or industrial use which would then aggravate the rice production situation of the country.

The rice price subsidy programme suffers from poor targeting and leakages to the non-poor (Jha and Mehta 2008, p. 2). Based on estimates made by the World Bank, the NFA rice subsidy programme has not been successful at targeting the poor, since the rice sold by the government agency "accounted for only 13 percent of the total spending on rice by the poorest quintile" (World Bank 2008, p. 26). This means that much of the NFA rice being sold at subsidized prices is not actually consumed by the poor to a degree thought necessary to reverse poverty in the country. According to Jha and Mehta (2008), "only 31 percent of the total consumption of NFA rice

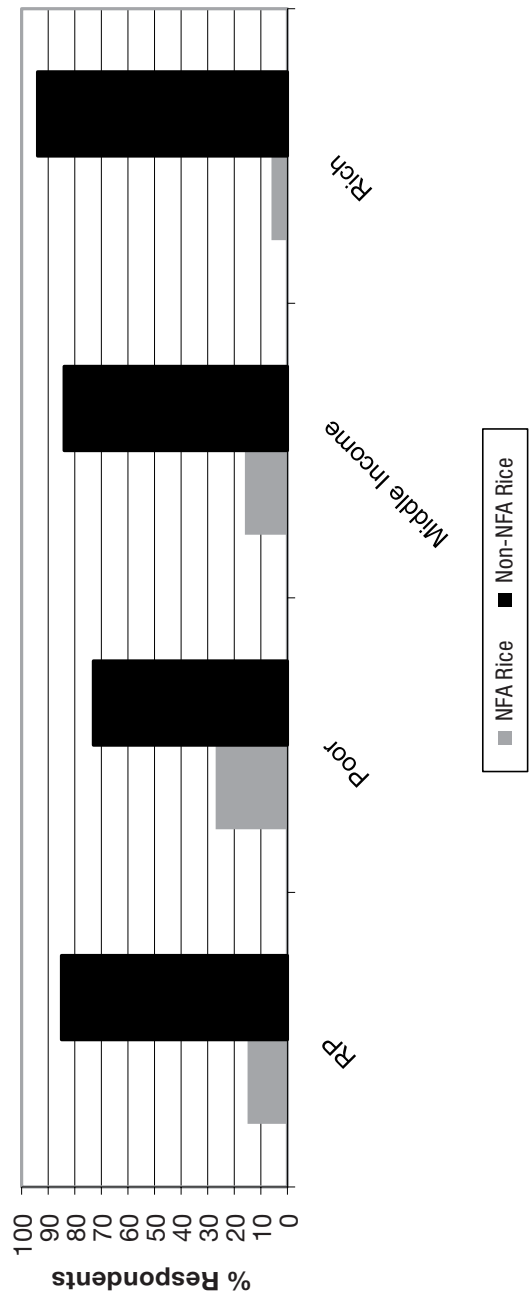
goes to the poorest quintile while as much as 41 percent leaks to non-poor households" and "the richest two quintiles accounted for 16 percent of total NFA rice consumed in 2006" (Jha and Mehta 2008, p. 26).

Studies have indicated that poor rice consumers do not ordinarily get this commodity from NFA stores. Only about 15 to 16 per cent of households nationwide buy NFA rice (Jha and Mehta 2008, p. 13; World Bank 2001, p. 106). The rest purchase their rice from non-NFA sources or private retailers. In fact, the same World Bank survey indicates that the poor are almost as likely to purchase non-NFA rice as those from non-poor households (Figure 9.21). Although 84 per cent of poor households purchase NFA rice, around the same percentage of non-poor (i.e., middle and rich income respondents), equivalent to 75 per cent, also avail of NFA rice (World Bank 2001, p. 107). Considering the fact that the rich and middle-income household respondents consume 48 kilograms and 42 kilograms of rice per month respectively, on average, compared to poor households, who consume 39 kilograms of rice per month, non-poor households actually benefit more from the sale of NFA rice than poor households (World Bank 2001, p. 107). Again, this implies a leakage of roughly 50 per cent. Indeed, these leakages to the non-poor can go as high as 80 per cent (Jha and Mehta 2008).

At the same time, there are also problems in the way that government agencies and local government units identify and target the poor in their localities. The determination of who is poor and who is not is made by local government officials usually without the benefit of hard data (i.e., local household census) (World Bank 2008, p. 26). Moreover, local governments are more likely to identify the poor as recipients of government assistance in order to win their political support.

Part of the poor targeting problem is manifested in the fact that the government rice subsidy programme suffers from a geographical deficiency because there is a mismatch between the actual incidence of poverty and the areas where these subsidies are given (Jha and Mehta 2008, p. 2). This means that the decision to identify areas that will benefit from subsidized rice prices are detached from the information that identifies the geographical areas where poverty is most prevalent, whether one speaks of its magnitude or in food subsistence terms (Jha and Mehta 2008, p. 2). Inasmuch as poverty in the Philippines is said to be essentially rural poverty, it seems that the price stabilization interventions undertaken by the government towards poverty alleviation have been concentrated in the urban areas, most notably Metro Manila.

FIGURE 9.21
Type of Rice Bought by Household Income Group



Source: World Bank (2001), Table 4.

CONCLUSIONS

Despite the fact that the country's GDP growth was higher compared to recent years, the poverty headcount had actually increased and had risen to its highest level in 2006 (World Bank 2008, p. 15). As regards its efforts to reduce poverty, the Philippine experience is not extraordinary. Normally, anti-poverty programmes encounter administrative, fiscal, and political challenges which can include "large administrative costs, corruption, inefficient implementation, and leakage" (Jha and Mehta 2008, p. 1). However, food subsidy programmes encounter even more problems and challenges making them unlikely candidates for any anti-poverty strategy over the long-term. A study by the Asian Development Bank suggests that rice "subsidies should be used only as a *stopgap policy*" (italics in the original, Jha and Mehta 2008, p. 1). In the long-term, it is better for the government to focus its anti-poverty programmes on raising the incomes of the poorest households in order to ensure adequate (or diversified) food intake. A programme that targets the chronically poor in terms of providing food subsidies can only work in the interim (Subbarao et al. 1996). This kind of precision targeting must also not be politicized, i.e., its determination must be as objective and accurate as possible. However, it is also likely that "precise targeting entails considerably more administrative costs and requires greater managerial skills" which would eventually increase the transfer cost per beneficiary, especially in the context of the increased cost of leakage (Subbarao et al. 1998, p. 20 citing Kennedy and Alderman 1987).

Rice subsidies can be seen as a means to temporarily alleviate the plight of the poor. The pursuit of rice price subsidies is seen as a short-run measure to protect the poor who are highly vulnerable to rice price shocks and fluctuations (see Timmer 2004). Politically, rice price subsidies are a means for the administration to win the support or tacit approval of the poor population. However, it is doubtful that such a policy undertaking would be financially sustainable or even desirable over the long-term given their high financial and administrative costs. The Philippine Government appears to be highly sensitive to the political significance of its rice subsidy programme but insensitive to the financial and fiscal implications of such a programme and the fact that it fails to have a serious positive impact on overall poverty in the country. The food security agenda of the Philippines particularly as it relates to the rice market and the availability of rice for the poor has become highly politicized. Its main intent is largely to ensure political stability for the incumbent administration rather than a genuine concern to raise the level of food security of the poor and reduce poverty (World Bank 2001, p. 103).

But given its limited means, government interventions to alleviate poverty would have to take efficiency into account. This would mean interventions aimed at reducing "the food consumption shortfall of a larger proportion of the poor rather than to eliminate the shortfall of a smaller proportion of the poor" (Subbarao et al. 1996, p. 14). Better targeting and designing programmes that are able to target more poor households would be the more effective and sustainable option for the country. This would also mean a departure from the current politically-motivated food subsidy programmes which have had negligible effect on the country's state of poverty.

In 1996 a World Bank paper recommended that the Philippine Government discontinue its rice subsidy programme. This action would have resulted in savings of up to 3 billion pesos annually, which could have been used for other poor-targeted programmes (Subbarao et al. 1996, p. 24). The same study also recommended that anti-poverty programmes be geographically targeted specific to those areas that show the highest poverty levels. Balisacan (1994) argues a geographically targeted approach to poverty reduction costing 2 billion pesos can reduce poverty by as much as a universal programme (not unlike the NFA's general food subsidy) that costs 18 billion pesos. In general, the food subsidy programme of the NFA "has had little effect on the poor's consumption and nutrition" (Subbarao et al. 1996, p. 23). Furthermore, this low impact was made at a high administrative and financial cost.

In sum, the rice price subsidies have not resulted in any substantial reduction of poverty in the country; have not really alleviated the plight of the poor; have been mainly used to drum up electoral and political support for the incumbent administrations; and have caused a significant drain on the country's fiscal assets to a degree that will take several generations to remedy and reverse. Any policy alternative in this regard would have to take these considerations into account, including the need to liberalize rice importation and to remove the regulatory hold of the government, which only strengthens the monopsonistic control of the commercial rice traders at the expense of both the rice farmers and poor consumers.

Notes

1. Initial drafts of this chapter were presented at the Conference on Poverty, Food, and Global Recession in Southeast Asia, Institute of Southeast Asian Studies (ISEAS), Singapore (25–26 March 2009) and the International Conference of the Philippine Political Science Association (PPSA) on "Re-imagining the Nation-State: Consensus and Conflict on Sovereignty and Autonomy",

General Santos City (3–4 April 2009). The author is especially grateful for the insights, comments, and suggestions of Dr Aris Ananta, Prof Richard Barichello, Mr Rodolfo Severino, Prof Alexander Magno, and Prof Felipe Miranda. However, the author bears the responsibility for all the data presented. Likewise, all the views expressed herein are those of the author and do not necessarily reflect the views of the University of the Philippines or the Department of Political Science.

2. About three million small-scale Filipino farmers depend on rice farming as their source of livelihood (Edralin and Collado 2005).
3. Such an anti-poverty framework is essentially a top-down approach with national authorities determining, in their best and expert judgment, what the rest of the country (especially the poor) needs.
4. The Asian Development Bank's poverty reduction programme is based on "three pillars of pro-poor economic growth, social development, and good governance" (Schelzig 2008, p. 10).
5. One of the key goals of the UNDP's Millennium Development Goals (MDG) is to halve poverty by 2015.
6. The 2006 Family Income and Expenditure Survey (FIES) of the National Statistics Office (NSO) shows that about two-thirds of the total expenditures of households in the Philippines earning 99,000 pesos and below annually are for food.
7. The country's gross domestic product grew by 7.2 per cent in 2007, the highest rate compared to previous years and past political administrations.
8. It is conceivable that Ferdinand Marcos, who was president during the Martial Law period (1972–1986), may have received a high dissatisfaction rating except that the situation at the time did not allow for an accurate and transparent survey to be conducted.
9. Television segments of government infomercials would typically end with ordinary Filipinos saying: *Ramdam ko ang asenso!* which literally means "I can feel the progress or prosperity!"
10. The fact that the people have to be reassured in this manner in the first place may speak of the extent of these achievements to the people: "If ordinary Filipinos could now actually feel the joys of the uplifted life, why bother to express it for them?" (De Quiros 2007).
11. In 1992, the government decided to exclude alcoholic beverages and cigarettes in computing the country's poverty threshold.
12. There is even speculation that the reason why the Philippines reduced its poverty threshold is so that it will not lag too far behind its neighbours in Southeast Asia (Mangahas 2011).
13. SWS usually administers its self-rated poverty survey every quarter.
14. The SWS survey asks the question: Where would you place your family along a continuum from not poor, on the poverty line, and poor. The error margin is ±3 per cent.

15. Also called subsistence poverty, the food poverty line refers to the minimum amount required for a family or individual to meet the basic food needs and nutritional requirements for necessary and socially desirable physical activities.
16. Analysts argue that the reason why the price of rice in the world market jumped so drastically was because the Philippines had decided to buy up nearly all the rice stocks being sold at the time.
17. Interestingly, Metro Manila had one of the lowest numbers of poor and food poor households in the country.
18. Most respondents would say that their most common form of help was money. The question asked was: In the past three months, did your family receive any of the following kinds of help? The error margin is ±3 per cent.
19. In addition to those indicated in PD No. 4, the food industry includes "raw / fresh and / or manufactured / processed / packaged food products" (Section 4).
20. There were even unconfirmed reports that key political figures in the Arroyo administration made huge profits from these imports and from investing in world rice futures.
21. Interestingly, Arroyo replaced Estrada who was ousted in a power grab in 2001. Since becoming the elected president in 2004, Arroyo has managed to fend off impeachment attempts in sequence since 2004 as well as coup attempts by idealistic and adventurist segments of the Philippine military.
22. Jha and Mehta (2008) estimate that a quarter of the subsidized NFA rice during the period 2003 and 2004 was distributed in Metro Manila (Jha and Mehta 2008, p. 6).
23. There have been unconfirmed reports of the overpricing of imports due to corruption and the involvement of middle-men.
24. However, Mears et al. (1974) argues that "the source of profit [of rice traders] is in astute trading of rice, not in the simple act of storing" in which the traders are able to take advantage of market information failures as well as the political mismanagement of the country's rice stocks (as cited by Intal and Garcia 2005, p. 10).

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10

THE IMPACT OF HIGH FOOD PRICES AND THE GLOBAL ECONOMIC DOWNTURN ON FOOD SECURITY IN CAMBODIA

Chan Sophal

Cambodia has not been spared from the pervasive impact of the global economic downturn. Certain sectors of the economy have been severely affected, very likely causing the economy to contract in 2009 for the first time in the past two decades. At the last quarter of 2009, the IMF, World Bank, and ADB, respectively, predicted growth of –2.75 per cent, –2.2 per cent, and –1.5 per cent for 2009, while the government predicted +2.1 per cent (UN Country Team 2009). The structure of the Cambodian economy is likely to change as its reliance on external factors has proven vulnerable. The economic and social impacts have been significant, especially as shown by job losses in the garment and construction sectors, less income amongst many households, and a likely increase in food insecurity amongst the 30 per cent of the population already living in poverty in 2007.

As everywhere in the world, prices of food and oil rose rapidly in Cambodia in the first half of 2008, only to slow in the second half of the year. Year-on-year inflation as measured by the consumer price index (CPI) went from a high of 13.7 per cent in January 2008 to 25.7 per cent in May and gradually declined to 13.5 per cent in December, according to the National

Institute of Statistics (NIS), which suspended the release of the CPI for some months until the national elections in July 2008 were over.[1] As the data was later released, the CPI for food items rose most rapidly, by 36.8 per cent in July, slowing to 23.2 per cent in December 2008. The price of rice, the most commonly consumed staple, jumped by approximately 100 per cent in May and remained 70 per cent higher than a year earlier in December. Fuel prices skyrocketed and plunged according to the international prices. The high inflation was largely attributable to international forces because Cambodia is a price taker for fuels and receives high prices for agricultural exports. For instance, the price of rice in international markets was up by about 180 per cent between July 2007 and June 2008 (CDRI 2008, p. 7).

While surplus producers and traders made handsome profits from the sudden rise in prices of agricultural commodities, a chief concern was the food security status of the Cambodian poor, who still accounted for about 30 per cent of the population, or four million people in 2008.[2] Food consumption for the poorest two quintiles constitutes 70 per cent of total household expenditure. Moreover, 65 per cent of rural households are either landless or land poor, according to the 2004 Cambodia Socio-Economic Survey (20 per cent landless and 45 per cent owning one hectare or less). One hectare of rice land produces a bare minimum of rice for a household of five, assuming the whole product can be kept for self consumption.[3] Therefore, the majority of rural residents do not produce a surplus but are net buyers of rice. Even among the net producers of wet season rice, much of the paddy was sold soon after the harvest, in November and December 2007, when the price had not yet increased significantly.

Cambodia was not alone in experiencing this unusually high inflation. Von Braun (2007), the World Bank (2008), and FAO (2008) expressed a strong concern about the impact of high commodity prices on developing countries, especially on the net food importers, mostly located in sub-Saharan Africa, and on the poorest sectors of the population, characterized by a higher percentage of basic food expenditure in total expenditure. At the same time, high international commodity prices may be a unique incentive to boost agricultural production in many developing countries, favouring rural development and supporting sustainable rural livelihoods. Whether this is actually happening, and under what conditions this would favour smallholder production, would be a study of interest.

Based on a robust ground of secondary and primary data, this chapter aims to explain the impact of high food prices for both consumers, especially vulnerable groups, and producers.[4] Efforts were made to identify opportunities and obstacles for farmers to benefit from the increase in agricultural prices.

The discussion is extended to address the potential impact of the global economic downturn, which followed the food price crisis, on food security and poverty in Cambodia.

The next section examines the impact of the global economic downturn on Cambodian economic growth, structure, and employment followed by a section discussing the data on price trends and their effects during the year of high prices. The subsequent section assesses the impact on household food security. The chapter then discusses the responses households adopted to cope with rising prices. It also addresses the potentials for and constraints on increasing food production to increase farmers' incomes. It summarizes the discussions in this chapter before concluding and providing policy recommendations to mitigate the impact on the poor.

ECONOMIC STRUCTURE, GROWTH, AND EMPLOYMENT

As is the case for many developing countries, the structure of the Cambodian economy has been changing significantly in recent years with the relative decline of agriculture, manufacturing, and services. The contribution of agriculture to the GDP steadily fell from 55.6 per cent in 1990 to 30 per cent in 2007. The manufacturing sector rose from only 11.2 per cent in 1990 to 26.8 per cent in 2007. The corresponding figures for the services sector are 33.2 per cent and 41.3 per cent (World Bank 2009).

Cambodia has achieved impressive economic growth over the past decade supported by four main pillars: tourism, garments, construction, and agriculture. Average growth for the last ten years stands at a remarkable 9.5 per cent, with the highest growth of 13.3 per cent in 2005. The essential underlying causes of high growth and the structural change are arguably the favourable access to the garment export markets granted by the United States and European Union, which effectively resulted in the sudden boom of garment factories. Growth in the tourism sector took place largely due to the attraction of ancient temples such as Angkor Wat. This growth was all made possible due to peace and macroeconomic stability achieved by the Royal Government of Cambodia (RGC) in cooperation with numerous development partners.

The main economic sectors of the Cambodian economy have expanded rapidly since the mid 1990s. Foreign tourists started to flock to the country in the late 1990s after the country achieved peace and political stability. There were only 20,000 foreign visitors in 1992 but the number rose rapidly to 2,125,000 in 2008. Tourism receipts contributed more than 13 per cent to the economy in 2007 (Ministry of Tourism 2008). The garment industry

employed 360,000 workers, mostly young female, at its peak in September 2008, having picked up from the late 1990s. Fueled by investment from Korea and China, Cambodia experienced a construction and real estate boom for most of the last decade. Agriculture has always been the backbone of rural Cambodia and has grown considerably in the past decade. It is expected to continue to grow by about 5 per cent, while the other three sectors are projected to decline substantially in 2009 (UN Country Team 2009).

In 2008, Cambodia achieved only modest growth of 6.5 per cent. However, the impact of the global economic crisis was beginning to be felt in Cambodia in the fourth quarter of 2008. The narrow base and lack of diversification has been pointed out in many studies before.[5] The global crisis has revealed this vulnerability of relying too heavily on the garment industry, on the tourism industry, and on construction, all of which are directly connected with foreign markets and capital. With demand for garments and the global tourism industry in decline, the Cambodian economy has been receiving substantially lower export receipts and has been experiencing a large number of lay-offs (63,000 garment workers were laid off). There is now recognition by the RGC that attention to and investment in agricultural and rural development should be increased. The immediate objective is to prepare the sector to absorb the laid-off workers from urban areas. The rural sector has a lot to offer in terms of development potential due to agriculture having vast potential for increased productivity, the expansion of cultivated areas, and improvement of processing capabilities.

Less than 20,000 firms have officially registered with the Ministry of Commerce and even fewer pay taxes and produce official annual accounts. At the same time, there is widespread corruption. The *Asian Development Outlook 2009* of the Asian Development Bank (ADB) highlights the lack of willingness to fight corruption by citing the fall on the corruption perceptions index to 166 out of 188 countries surveyed in 2008 by Transparency International. It is likely that firms are forced to make informal payments or bribes and try to avoid paying taxes. They cannot afford to register and pay taxes properly while also still paying informal taxes. There would be a loss of competitiveness for the businesses who decide to become formal while others remain informal. However, as long as businesses stay informal, they have less access to capital. Commercial banks find it difficult to assess informal businesses in order to lend money. Private equity funds require even more paperwork before the injection of capital to buy part or all of the business. One of the biggest concerns for the forthcoming stock market in Cambodia is the lack of firms that practice proper accounting standards and therefore their inability to be listed on the stock market.

There should be increased incentives for firms to become formal, pay taxes, and have accounts and balance sheets that are properly audited. This would entail the complete transformation of the method of doing business in Cambodia and the politics that goes with it. Politics in Cambodia is characterized by pleasing voters through personal donations by civil servants, which are far greater than their government salaries.

However, Cambodia has been adversely affected by the global economic downturn since late 2008. The global economic downturn will undoubtedly reduce growth in Cambodia in 2009 and 2010. After growing at double digits from 2004 to 2007, the Cambodian economy slowed to a modest 6.5 per cent growth in 2008, with economic activities decelerating remarkably in the fourth quarter of 2008. In December 2008, the ADB, the International Monetary Fund (IMF), and the World Bank predicted Cambodia's GDP would grow in 2009 at 4.7 per cent, 4.8 per cent, and 4.9 per cent, respectively. However, the numbers were since revised sharply downwards to 2.5 per cent, –0.5 per cent and –1.0 per cent, respectively. In the last quarter of 2009, these institutions revised their projections more negatively, and projected growth of 4 per cent in 2010. The Cambodian Government projected 6 per cent growth in December 2008 but revised its prediction to 2.1 per cent in the second half of 2009.

The negative unfolding impact is likely to continue over the coming year. Without stock markets, major short-term foreign debts or cross-border inter-bank liabilities, and portfolio investment, the Cambodian economy is not exposed to the problem of short-term or liquid liabilities. However, its real sector has been negatively affected largely because it is narrowly based, urban-centric, and lacks a vibrant rural economy. The global crisis has proven that Cambodia is vulnerable by being heavily reliant on garment exports, largely to the U.S. and European Union markets, and by being reliant on tourism particularly in Siem Reap province. Foreign direct investment (FDI) has been concentrated in these two sectors, leading arguably to the boom and bust of the construction and property sectors, further compounded by the collapse in the world property market.

There is a strong consensus that the garment, tourism, and construction sectors are going to contract. However, the level of contraction is widely disputed. Data for 2009 shows that garment exports declined by 16 per cent compared to 2008. Tourist arrivals decreased by 3.5 per cent in the first quarter from 644,205 in 2008 to 622,288 visitors in 2009 but increased a little bit for the whole of 2009 due to more cross-border visits from Vietnam, which brought less money than those from Korea and Japan. Political instability in neighbouring Thailand and the outbreak of AH1N1 flu contributed

to the slowdown in the second half of the year. The construction sector, which has been relying heavily on FDI, was experiencing a remarkable decline following the credit crunch in the home countries of investors as well as the burst of the bubble in the real estate market. The recovery of the three sectors is directly linked to recovery in the global market. For instance, the garment markets depend on demand from the United States, although to some extent they also depend on improvement in the competitiveness of Cambodia. Recovery in the main sources of FDI — Korea and China — would also help. Given this, the Cambodian economy is likely to grow at a very low rate, if not contract, in 2009 and the slowdown is likely to continue well into 2010.

The contraction of the manufacturing sector and services sector has resulted in the loss of tens of thousands of jobs, for people coming mostly from rural areas. It is expected that rural households will have to absorb laid-off workers back into the rural economy. However, there has been underinvestment and underdevelopment in the rural sector, where 90 per cent of the poor reside. As many households are no longer receiving remittances from urban areas as a result of the economic crisis, it is questionable whether the rural sector will actually be able to absorb the large number of unemployed, especially as the agriculture sector is suffering losses due to the drastic decline in the prices of several agricultural commodities. In a low-income country such as Cambodia, a reversal of economic growth not only has a negative impact on current income levels but also undermines long-term achievements in human development.

The most significant job losses have been in the garment sector, which laid off 63,000 workers or 18 per cent of the peak workforce between September 2008 and March 2009 (UN Country Team 2009). In terms of income or earnings of foreign exchange, it is a significant loss since garment exports in the first four months of 2009 declined by 27 per cent compared to the same four months in 2008. The loss of these jobs means a loss of US$6.2 million each month in salaries to be accrued to workers. This has alarmed policymakers and stakeholders. The government has responded with a fund allocation to retrain some of the laid-off workers and is encouraging greater investment in the agricultural sector in order to facilitate the absorption of workers back into rural communities. Most of the garment workers are young females from rural areas. However, anecdotes show that not every worker who has been laid-off is returning to rural areas (UN Country Team 2009). Many are remaining in Phnom Penh looking for different jobs or staying with their spouses. No studies or surveys to date have been able to state exactly how many laid-off workers returned to rural areas, how many have found other

types of employment, and how many are remaining in the city continuing to look for jobs.[6]

There are no clear statistics on the number of construction workers that have been laid off because this industry generates a lot of informal employment. However, it was estimated that the construction industry generated about 3.6 per cent of total employment. It is one of the sectors that have been directly affected by the global economic crisis as well as the subsequent cut in spending in the country. Tens of thousands of jobs are estimated to have been lost in the past eight months (ILO 2009).

Tourism industry workers include those working in hotels and guesthouses, travel agencies and tour operators, tour guides, restaurants, massage shops, souvenir sellers, transporters (buses, taxi, tuk-tuk, and moto-taxi). A rapid assessment conducted by ILO (2009) during December 2008 and January 2009 reports that these workers were still holding on to their jobs, no massive lay-offs by employers, while the self-employed were making less money. Since April 2009 the situation has deteriorated due not only to the impact of the financial/economic crisis, but also to the fear of contracting Influenza A (H1N1) while travelling.

Agriculture is the only sector that was predicted not to decline in 2009, assuming there is no drought towards the end of the year.[7] Since growth is based on actual production of crops with constant prices assumed, it is likely that it will grow by around 5 per cent, as predicted by the ADB. However, in terms of revenue, farmers were worse off compared to 2008 because many crops had lower prices. Farmers had encountered high production costs, especially the costs of labour, machinery, and fertilizer in 2008, though prices began to fall in 2009.

The reduction in global demand also resulted in a sudden sharp decline in the price of cassava and rubber, and a substantial decrease in the price of maize, rice, and cashew nuts in late 2008, although these prices had risen partly due to speculation by the forces external to Cambodia in the first half of the year. The problem was that when prices of these crops were rising, production costs also jumped remarkably. A nationally representative survey of households to assess the impact of the high food prices found that labour costs increased by 47 per cent and agricultural production costs accelerated by 30 to 50 per cent, due partly to the tripling in the price of fertilizer and the 50 per cent increase in the price of diesel and gasoline (CDRI 2008). Cambodian farmers expected the prices of their products to stay high and did not mind paying or borrowing money for high costs of inputs. Unfortunately, the prices of these crops declined drastically and many farmers incurred losses or made little profits, if any, in the first half of 2009. Prices of agricultural

commodities started to rebound in the second half of 2009 to a level higher than 2007, raising concerns for the food deficit groups again.

The countries receiving Cambodian labour migrants, namely Korea, Malaysia, and Thailand, have not been spared by the global financial and economic crisis. This has significantly affected both the flow of Cambodian migrant workers and those working overseas, according to experts following the case. New sendings have been very limited in 2009 as the host countries are under pressure to create employment for their own workers. In the case of Thailand, a number of Thai migrants have been sent home from better-off countries where they worked. Fortunately, not many Thai workers want the "3D jobs" (dirty, difficult, and dangerous). So Cambodian migrants can continue to stay and work in Thailand. However, overtime work in factories, which is a primary source of extra income for the migrants to save for remittances, was reportedly reduced substantially. The security and legal environment also became tougher for migrants entering Thailand without legal means. It should be noted that only 8,231 migrant workers had been formally sent to Thailand, while about 200,000 workers entered Thailand without legal documents, although some were regularized later.

In 2009, the number of workers that completed their employment contract or visa duration and had to return from Malaysia, Korea, and Thailand was 6,000, 3,500 and 3,000 respectively. Normally, new workers are sent to these countries, other things being equal, but not this year. Thus, prospects for remittances in 2009 and 2010 do not look good.

The second order impact victims are among those who are impacted as a result of being dependent on those directly affected by the crisis. Through the multiplier and interdependency effects, the impact of the economic downturn is spread from one group to another. The direct impact on the groups of people reported above, in turn worsens the livelihoods of those dependent on them. For instance, laid-off garment workers are first-order impact victims of the economic crisis, while their family or dependants at home are also adversely affected as a consequence and considered as second-order impact victims. Since data collection was limited, much of the assessments herein are more of an indicative or suggestive nature rather than being conclusive.

PRICE TRENDS AND EFFECTS

In 2008 Cambodia faced rising prices of consumer and producer goods, essentially food, fuels, and labour. The consumer price index in May 2008 was up 25.7 per cent from May 2007 and remained relatively high at 13.5 per cent in December 2008.[8] The category of food, beverages, and tobacco

contributed the most to inflation throughout 2008; inflation in this category was as high as 45.8 per cent in May. Due to the sharp rise in oil prices, the cost rise of transportation and communication was above 20 per cent in the second quarter. The price index of furniture and household operations was up more than 20 per cent for most of the year. At the low end were personal care and effects, clothing and footwear, recreation and education.

Since food prices rose most and food matters most for the poor, it is important to examine the movement of the prices of a number of essential food items consumed by the poor. It is to be noted that not all essential food items became significantly more expensive during the high inflation period. This provided room for people to choose between substitutes. However, the most staple food, rice, increased the most in price. The price of top quality rice almost doubled, from 1,650 to 3,100 riels per kilogram (or US$0.76, at the exchange rate of 4,100 riels per US$) in May 2008 and remained high until it came down to 2,670 riels in December 2008, when wet-season rice was harvested. Substantial increases also occurred in the prices of meat, poultry, and eggs, and to a lesser extent for fish and vegetables. For space reasons, figures for July, September, and November, which are not of significant difference in the trend, are not presented.

The peak period for all types of rice was in May 2008, when average prices rose to about US$1,000 per tonne. Prices then came down gradually to between US$400 and US$700 per tonne. The trend is similar to that in Cambodia. The steep increase in the first quarter of 2008 prompted rice export bans in some countries, aimed at containing domestic food prices. However, this limited the supply and thus further fuelled price increases. On average, the price of rice in the world market escalated by an unprecedented 180 per cent from July 2007 to June 2008.

In Cambodia a rice export ban was in effect between 23 March and 23 May 2008, which contained the increase or even reduced the price of rice by about 10 per cent immediately it was introduced. The ban was short-lived because much of the dry-season harvest in April and May had nowhere to be stored, and Cambodia produced more than 2.5 million tonnes of paddy in surplus, having achieved 6.7 million tonnes in 2007/08 (MAFF 2008). This intervention reduced the potentially higher profit of producers and traders of dry season rice but cut down the cost of rice for consumers, especially the poor, who far outnumber the producers and traders.

Wholesale prices of paddy rice collected by the Marketing Office of the Ministry of Agriculture, Forestry and Fisheries (MAFF) increased slightly less than those of milled rice — 75 to 100 per cent — between May 2007 and May 2008. The paddy price increase took place in all the provinces surveyed

by the MAFF. The average price in May 2008 ranged between 1,150 and 1,500 riels per kilogram, compared with 500–900 riels a year earlier. As of December 2008, soon after the harvest, the prices of paddy rice came down slightly but were still good for farmers. The top quality paddy was sold at US$285 per tonne, the second quality at US$200–220.

One kilogram of paddy rice is equal to 0.65 kilograms of milled rice, so the price of paddy should be 65 per cent of that of milled rice, without considering transport and other costs. The price ratio of lower quality rice such as the IR variety tends to be reasonable. However, the retail prices of higher-end milled rice are more than double paddy (3,500 riels per kilogram, compared with 1,500 riels per kilogram). This indicates bigger margins between wholesale and retail prices for better-off consumers.

In our group interviews with village representatives or key informants, attempts were made to document how people understand the reasons that the prices of milled rice had increased remarkably. Most respondents mentioned trade factors or something to do with market forces, followed by rising costs of inputs. The focus group discussions with farmers in twelve villages found doubts whether prices would remain high when people sold their paddy in November–December 2008 and beyond. It turned out to be true that prices came down compared to May and June 2008.

The prices of consumer goods have been rising along with producer goods, and it is difficult to determine causality. In theory, rising costs of inputs such as fuel and labour push up the prices of output. It is also true that rising demand (including external demand) can pull up the prices of consumer goods, and then workers demand higher wages. When wages rise, production costs increase, raising inflation. Cambodia is purely a price taker for fuel. Because fuels are inputs for agricultural production and transport, the rise in world fuel prices has directly affected production and marketing costs.

The price of gasoline in Phnom Penh increased by 41 per cent from July 2007 to July 2008 before it plummeted to the lowest level in two years. The price of diesel, which is more commonly used for agricultural machinery, rose 77 per cent before falling. Tax rates on fuel have been constant for more than ten years. Therefore, the increase in fuel prices has been solely due to international factors. Recently, many farmers have replaced draught animals with hand tractors or tractors. This has caused them to suffer from the drastic increase in the price of diesel, especially in the first half of 2008.

Many farmers were adversely affected by the steep increase of fertilizer prices, according to the focus group discussions and household surveys. Prices of fertilizer increased by about 1.5 times in the first half of the year. Wet-season rice farmers, who were yet to benefit from the better prices

for paddy, now faced a steep rise in fertilizer cost. There was concern that they might cut back the amount used and therefore harvest less. However, based on our study, farmers would rather take a cash loan or buy fertilizer on credit because they did not want to reduce their yield when the price of paddy was high. The Ministry of Agriculture found a remarkable variation among provinces of prices of the same kinds of fertilizer in the same month. Unlike fuels, the prices of fertilizer did not decrease significantly in November–December.

All chemical fertilizers are imported, mostly through Vietnam. The costs of fertilizer and fuels were the major concerns of farmers. In the past, fertilizer was subsidized by the government. The subsidy did not last because it did not work well; farmers still ended up paying market prices. Any attempt to make the fertilizer subsidy work would be much welcomed by farmers. Anecdotally, there is room for improvement in the import of fertilizer. This business seems to be monopolized by a few traders.

Another crucial variable for farming is labour. Day wages are both income for workers, most of whom are poor, and a cost for farmers. Most of the poor rely on day labour for subsistence; it is said they "live from hand to mouth". Day wages had increased by 35 to 67 per cent over one year by the time of the survey in June 2008. While this contributed to rising prices of products, it was essential in compensating the poor. In May–June, the median daily wage was 10,000–13,500 riels. The annual increase was about US$1 per day, or 45 per cent on average, confirmed by the village checklist and focus group discussions. This is significant for maintaining the purchasing power of the poor.

According to many sources, it is most unlikely that rising prices of food will be reversed to the level of a few years ago, because the supply faces physical constraints while global demand keeps increasing due to rising income, especially in China and India. The big rise in the second quarter of 2008 was fuelled by speculative demand, precautionary demand for food stocks, policy responses of exporting countries, rising energy prices, energy intensity of agriculture, and diversion of cereal to biofuels (ADB 2008).

The worry in early 2008 was that high food prices were undermining poverty reduction. As in other developing countries, expenditures for food are a large part of total expenditure. The share is even larger for those who live near or below the poverty line. Food price inflation seriously eroded their purchasing power, increasing food deprivation and malnutrition. These effects were expected to worsen if high food prices did not persist in the second half of 2008 and first half of 2009, when in fact food prices

came down substantially. Fortunately, wages then were raised to compensate workers for having to pay more for the same quantity of goods. The problem is that not everyone had equal access to employment or even day labour. The demand for labour was not being met in some areas where there were new opportunities for farm expansion or land clearing. On the other hand, some areas did not have these opportunities, and people were desperate for employment. This suggests a mismatch in labour markets and a need for better information and labour flow.

HOUSEHOLD FOOD SECURITY

Given the limited resources and time for the study, it was not possible to measure direct food consumption in terms of measuring quantity of food consumed by households across the country. The assessment of food consumption was limited to asking how frequently households consumed the identified essential food items and how they obtained them within the previous seven days. Standard scores developed by the United Nations World Food Programme (WFP) were then applied to determine whether households were food poor or not.

A nationally-representative sample household survey was conducted in June 2008 to assess the impact of high food prices on household food security and potential responses to high commodity prices. In addition, focused group discussions complemented the household survey. The survey selected 2,235 households on a random, probability proportional to size, method. Covering 24 provinces and 149 villages (15 households per village), the survey was used to assess how high food prices affected the households in different locations and what coping strategies were being employed by adversely affected households. It also attempted to capture the dynamic picture of the agricultural situation in the aftermath of rising costs and prices.

In addition, 14 "target villages" were selected to represent special areas of interest such as the urban poor, the rural poor, wet-season rice farmers, dry-season farmers, fishing communities and other cash crop producers, which theoretically have been affected differently by high prices. In each target village, about 70 households were randomly chosen for interviews and thus a total of 991 households were selected from the 14 target villages.[9]

Diets in Cambodia are as diverse as cultural beliefs and livelihood systems. Rice is the main staple food. In order to examine the food consumption pattern, the sampled households were asked to report how many days they consumed a series of food items in the week prior to data collection and the sources of foods consumed. In nutrition, different food items are divided into

a number of groups, of which a combination should be consumed daily to ensure an adequate diet. The key food groups are cereals and tubers, pulses, meat and fish, vegetables, fruit, milk, sugar, oils and fats.

The survey found that the rural households have, on average, a poorer food intake than the urban households. In general the primary position of Phnom Penh emerges, but no big differences can be noted between the capital and other urban areas. More than 300,000 households (about 1.7 million individuals, or 13 per cent of the population) were food insecure, as classified by the WFP method, in May–June 2008.

Food insecurity in Cambodia is mainly a rural problem; more than 1.5 million of the rural and more than 150,000 of the urban population (including Phnom Penh) are food insecure. The "chronically food insecure", who are least prepared to cope with high food prices, require particular attention. People in this category are most at risk of entering a dispossession spiral leading to social marginalization and serious food insecurity.

According to the survey, 4.3 per cent of Cambodian households were chronically food insecure or had poor food consumption. This corresponds to more than 600,000 people living in more than 120,000 households. Nearly 50 per cent of the poor food consumption is located in rural Tonle Sap, followed by plains (38 per cent). The plains ecological zone is the only one (aside from Phnom Penh) where poor food consumption households are present in urban areas. The survey found that landlessness is significantly higher among food-poor rural households than in the overall rural population. The food-poor households in rural areas have more children and more elderly to be cared for. The other urban areas and particularly Phnom Penh enjoy a more favourable situation of fewer dependants.

Ninety-two per cent of the households declared that their expenditure had had to increase since December 2007. The highest proportion of expenditure increase and newly incurred debts were found among food-poor households. The consequences can be dramatic, because this category is the most affected by debts. Perhaps even more worrying is that they had incurred many more debts than the overall population in the previous few months (since March 2008). The proportion of poor food consumption households that contracted new debt was more than 50 per cent, higher than for the overall rural population.

The drop-out rates of primary schoolchildren were highest among the food-poor households. Between January and June 2008, their drop-out rate almost doubled, affecting more than one-fifth of the food-poor children in primary schools. However, there is no direct evidence that this increase was due to price increases.

The household survey also identified "borderline consumption households" — those considered vulnerable to becoming food insecure should a small decrease in their access to food occur. This category should be attentively monitored during the next months, as it is highly sensitive even to small changes in prices.

This category currently corresponds to more than a million people living in more than 200,000 households. Borderline consumption households are more scattered throughout the country than the poor consumption households. More than 90 per cent of the borderline households are in rural areas. A small number of borderline households were in urban Tonle Sap and very small numbers in the urban coastal and plateau zone. About 88 per cent of households reported that they had faced difficulty in May 2008. However, 76 per cent said they did so in May 2007, implying that high food prices might have affected only 12 per cent. Again, answers to this kind of question should be taken with a grain of salt, because the degree of difficulty may be different.

The major difficulties reported in May 2008 included the high prices of food (53 per cent of responses), followed by sickness or health expenditures (27 per cent), high fuel prices or transportation costs (25 per cent), and repaying outstanding loans (19 per cent). The proportion of households that reported lack of money to buy food and cover essential expenses increased more rapidly in Phnom Penh and other urban areas — from 37 to 79 per cent and 46 to 91 per cent, respectively, between May 2007 and May 2008.

In the 14 target villages, 62 per cent of villagers reported that they did not have enough money to buy food or cover essential expenses in June 2007, and in June 2008 this number rose to 69 per cent. The change was quite significant among fishing and land-abundant villages, the former increasing from 66 per cent in 2007 to 98 per cent in 2008 and the latter from 64 per cent to 88 per cent. Villages with the least number of people with inadequate money, about 49 per cent, were cash-crop villages.

HOUSEHOLD COPING STRATEGIES

The large amount of information provided by surveyed households about their coping mechanisms during the previous thirty days is a very useful contribution for understanding the impact of rising prices and the seriousness of their immediate and long-term effects. The most frequent measures for coping mechanism is related to access to food. This is essentially about rural areas. The selling of land, fixed assets, animals apparently did not show differences between poor households and the overall rural population.

However, it should be considered that the majority of food-poor households are landless, or had no land to sell.

Households had adopted various ways to cope with difficulties. Many people bought cheaper food or reduced the amount of food consumed, especially for female adults and elderly members. Many purchased food on credit or relied on help or loans from friends and relatives. The nationally representative survey found that about 37 per cent of villagers reported that they never relied on less-preferred or less-expensive food, while 24 per cent replied that they often did, and another 24 per cent sometimes did this. The reliance on less-preferred and less-expensive food was highest among fishing communities. About 26 per cent sometimes borrowed food or relied on help from friends or relatives, while 60 per cent had never used this strategy. Of interest to note, 38.5 per cent sometimes purchased food on credit or incurred debts to cover food expenses, while 42.5 per cent had never done so.

About 34 per cent often or sometimes reduced the amount of food consumed. This was considerably more common in fishing villages than in others, as about 29 per cent would do this every day. In 23 per cent of target households, adults had sometimes restricted the amount of food they consumed in order for small children to eat.

As many as 21 per cent of mothers and/or elder sisters had to eat less than other household members. More fishing and poor villagers used this strategy. In the worst cases, mothers and/or elder sisters skipped meals, and around 8 per cent of them had skipped more than one meal. About 12 per cent of households had sometimes decreased expenditure for health care, and 12 per cent had sought alternative or additional jobs. Thirteen per cent sometimes or often increased exploitation of common property resources. Land-abundant villages did this least, while fishing villagers did it most, 42 per cent of households there having done so from often to every day.

About 12 per cent of villagers sometimes planted more or new crops to cope with high food prices, about 10 per cent doing so quite often. Cash-crop villages did this most often, while fishing and land-abundant villages did so least. Around 48 per cent of the villagers had received assistance, 40 per cent as free health care from non-governmental organizations (NGOs), micro-credit and cash transfers from social programmes. However, villagers responded that they would most prefer free health care and drugs from NGOs, cash transfers from social assistance, and free food. Rice growing villages also preferred seeds and fertilizer; cash-crop villages preferred agricultural tools; fishing villages preferred food for schoolchildren; and the poor preferred free food for the household.

The impacts of high food prices, according to the responses by affected households, will be further natural resource depletion and increased migration, indicated by the considerable number of households that were looking for alternative or additional jobs. Children would then be taken care of by the elderly or more burden put on females, who already tend to have poor food consumption. Within just a few months of high food prices, more of the food insecure households withdrew their children from school, probably to help in earning or because they could not afford to pay for schooling. It is difficult to draw conclusions from these very few responses, but the survey does suggest that more female than male children are withdrawn from school to help their parents cope with such hardships.

In addition to the above coping mechanisms, there are some other ways, though not as frequently used. Some had been forced to sell their livestock when they needed cash, some incurred debts, and others migrated.

Distress Sale of Land and Other Assets

The households with difficulties reporting sales of cows or buffaloes were 48 per cent in the coastal zone, 30 per cent in the plateau, 38 per cent in the Tonle Sap, and 37 per cent in the plains. The proportion of households selling pigs showed a similar trend, being highest (59 per cent) in the coastal zone, followed by the Tonle Sap, the other zones being not more than 35 per cent. Selling livestock and productive assets, however, is not the way for households to recover from family shock or crisis. Not all households possess such assets, and very few households reported selling animals to cope with difficulties. Many households may run out of assets to cope with shocks, especially if food prices continue to rise.

The survey also revealed the number of households planning to sell their land in the following season if they could not cope with their difficulties. Although very few households had sold land, 478 planned to sell some of their agricultural land in the next season. The number was highest, 274, in the plains, 14 in the coastal zone, and 119 in the Tonle Sap.

Taking Loans

Fifty-three per cent of households reported that they had debts at the time of the national survey, and 32 per cent of the total had incurred debts in the previous six months. This is quite alarming as loans provided by informal moneylenders have very high interest rates, ranging from 60 per cent to 120 per cent per annum, while micro finance institutions charge 50 per

cent interest on average. Once households fall in debt, it is very difficult to climb out.

Of the households facing difficulties, 57 per cent reported having outstanding loans in June 2008. Among these, 35 per cent took new loans between March and June 2008. A large number of households (42 per cent) in Phnom Penh took loans for business expansion. By contrast, a majority of the households in the four ecological zones used loans for non-productive purposes. More people have been pushed to take new loans to buy food in Tonle Sap (49 per cent), plateau (47 per cent), and costal zones (31 per cent).

Although the hardships reflected in borrowing are not all due to high food and commodity prices, almost half of the new borrowers lacked cash to cover health expenditures and food. Rising food prices to some extent also created opportunities; 18 per cent of households took loans to enlarge their businesses. However, the survey did not ask about the types and returns of businesses.

Migration

Of the total survey, about 19 per cent of households reported having members working elsewhere. The percentage of households with migrant members was much higher in rural than in urban areas. The survey found that households in the urban areas of the plateau region had the highest percentage of migrants, followed by rural plains and rural Tonle Sap families.

About 15.5 per cent of the target households had members who were working elsewhere; the percentage of males was a bit higher than that of females. About 7.5 per cent of these migrants worked in urban areas and another 5 per cent in rural areas in Cambodia; the remainder worked in Thailand. The main reasons for migration were to find income and to cope with high food prices. Other reasons included seasonal migration.

The percentage of men leaving villages in search of employment is higher than that of women. The survey found that 67 per cent of migrant members in urban areas were men. In rural areas, the percentage of male migrants is 54 per cent. Interestingly, in the urban plateau, the percentage of female migrants is higher.

The majority of migrants — 47 per cent of urban migrants and 58 per cent of rural migrants — went to work in urban areas in Cambodia, regardless of where they were from. The second main destination was rural Cambodia, the third Thailand. The percentage of urban migrants working in Thailand is much higher than that of rural migrants, suggesting a big gap between the two groups in access to employment in Thailand.

The survey found that most migrants, urban and rural, left to earn money for their households. The urban plateau had the highest percentage in this category. The second major reason was to cope with high food prices. The urban plain was where most people cited high food prices as the factor pushing them to migrate.

RAISING FOOD SUPPLY: POTENTIAL AND CONSTRAINTS

The survey found that a large number of target rural households owned at least one plot of agricultural land. However, about 21 per cent of them did not hold any land. Those in plains areas constitute most of those who do not own land. Of owned plots, about 69 per cent were used for wet season rice, around 15 per cent for dry season rice, and 12 per cent for *chamkar* or other crops besides rice.[10]

While around 43 per cent reported a decrease in their production, those in plains, Tonle Sap, and plateau regions did not suffer this as much as coastal areas, where all respondents claimed a production decrease. Despite this, only about 2 per cent planned to sell their land within the next six months. The percentage was lowest in the plateau. This is not surprising since the land market is not very active in those rural areas.

During the last season, about 91 per cent of the land was cultivated. On top of this, quite a number of those in the plains and Tonle Sap regions also used their land for sharecropping or left it idle or for someone else to cultivate for free. There was a small increase in the number of those who planned to cultivate their land in the next season, while some of those in plains and Tonle Sap also planned to let it. Although the change was quite small, it demonstrates some changes of attitude in response to increased prices of agricultural commodities. It is important to discuss the potential of increasing production and potential profits by major crop.

Sixty-nine per cent of agricultural plots had been used to cultivate wet season rice during the previous season. Wet season rice farmers, on average, owned 0.9 hectares, which produced 1,068 kilograms of paddy rice with a value of US$278. Considerable amounts of money had to be spent on inputs. The average farmer spent a total of US$86 on production costs, a large part of that on seed, land preparation, and transplanting. Subtracting the costs, they had a net profit of US$192 from growing wet season rice during the survey period.

In the twelve target villages, the average farmer owned 1.9 hectares and produced about four tonnes of paddy rice. Farmers in those villages put a

relatively large amount of money into production: a total of US$358 to cover the cost of seed, ploughing, transplanting, harvesting and so on. At the end of the season, they earned a net profit of around US$417. The farmers in the special village sample earned more than those in the national sample simply because they had more farmland.

Disaggregation of production according to land size also yields an interesting result. On average, those who had more land to grow wet season rice had better harvests and higher net profits. However, in spite of this, large landholders tended to use land less productively than small landholders: the yield per hectare decreased considerably as the size of land increased.

According to the survey, 58.6 per cent of wet season rice producers might face rice shortages before the next harvest.[11] The plateau has the highest proportion of rice shortage households, 67.6 per cent, followed by Tonle Sap (63.3 per cent), and coastal (58.4 per cent).

Dry season rice production took up about 15 per cent of agricultural plots. Households that engage in dry season rice production average about one hectare of agricultural land. During the survey season, they were able to collect 3,145 kilograms of paddy rice, which is equivalent to US$708 in cash. Dry season rice, however, is much more costly to produce than wet season rice because of the need to pump water and purchase fertilizer. The total production cost averaged US$334 during the last season. Hence, an average farmer gained approximately US$374 profit. Farmers in the target villages possessed 0.5 hectares and produced 2,213 kilograms of paddy rice, or around US$458 per plot. After taking all production costs into account, an average farm household growing dry season rice earned about US$271 per hectare.

Consistent with findings on wet season rice production, dry rice farmers with more land were found to generate higher net profits per plot but tended to use land less effectively than small landholders. In general, dry season rice producers had the highest degree of rice sufficiency: 57.4 per cent had sufficient stock for consumption until the next harvest. The highest percentage was found in the Tonle Sap region.

The average plot size was 0.8 hectares, which produced 1,051 kilograms of maize during the previous season. Maize provided a higher profit than wet season rice, and its production cost was reasonable, estimated as US$46 per plot, consisting largely of seed, land preparation, and planting seedlings. During the previous season, maize producers generated profits of about US$191 per plot. In the studied villages, an average farmer produced around 17 tonnes of maize from five hectares and earned as much as US$2,500 from it. Production costs totalled US$1,300, leaving US$1,200 as profit.

Cassava cultivation attracted more attention from Cambodian farmers due to the tripling in price in early 2008. In the sample survey, the average cassava farmer possessed two plots of 1.6 hectares each, with an estimated value of around US$4,700 per plot (or US$2,937 per hectare). Land for cassava seems to have a higher value than any other type of agricultural land.

The average cassava harvest during the previous season was 4,378 kilograms per plot, worth US$550. A total of around US$130 was required for ploughing, harvesting, processing, transporting, and other costs. Cassava is easier to plant and care for than rice or maize. Yet it also provided a profit of around US$537 per hectare during the high price in early 2008. Despite this higher income, the majority of cassava growers perceived a threat of having no paddy in stock. In 2009, they were hard hit by the sharp decline in the prices of cassava produce. Some had incurred big losses as they had experienced rising costs of production in 2008.

Three major constraints on increasing agricultural production were reported: lack of money for fertilizers, irrigation issues and lack of household labour or draught animals. Other constraints included insufficient capital to hire labour or ploughing, not enough machinery, flood or drought, and inadequate knowledge or training to use inputs and technology more productively. Policies to remove these constraints may result in an increase in production and help reduce the poverty and vulnerability of farmers.

Productivity could be marginally increased by resolving land conflicts. In the survey, about 2 per cent of plots were reported to be in conflict. Land conflicts are an issue because farmers cannot use the land to its maximum potential. The study showed that about 44 per cent of conflicted plots were associated with declines in productivity.

The percentage of farmers who would grow crops on their idle farmland during the coming season was small and the percentage of farmers who would grow for business purposes was still lower. Only 10.6 per cent of households would increase production solely for sale, against 47 per cent that would use extra harvest for household consumption. This indicated that not many farmers saw high food prices as an opportunity yet.

CONCLUSIONS

Many attribute high world food prices in most of 2008 to greater demand for food and fuels in China, India and other countries, while sizeable portions of land have been allocated to biofuels. Cambodia is an open and small economy that produces surpluses of a few major crops such as rice, soybeans, maize, cassava, cashews, sesame, and rubber. Higher prices for

these crops mean Cambodia earns more from exports. The survey found that dry season rice farmers and cassava farmers had benefited from the increase in prices, while wet season rice farmers and others who would harvest in November–December 2008 also stood to benefit if prices remained high. However, prices of most crops came down by November and December 2008. In general, production costs in 2008 rose about 50 per cent but farm gate prices at the end of 2008 fell by 7 to 57 per cent, except for rice which continued to be 11 per cent more expensive compared to a year ago. This resulted in gross margins declining dramatically. Gross margins for wet season rice went down by 10 per cent although prices were still 11 per cent higher than in late 2007. Gross margins for cassava were reduced by 166 per cent, making a loss of $180 per hectare. This hurt many cassava producers, most of whom were already poor. They were inspired by the drastic rise in early 2008 as cassava was used for biofuel production as a substitute to fossil fuels. It could be inferred that poverty is likely to increase in 2009 as a result of the pervasive impact of the steep drop in agricultural prices when people had already incurred high production costs in 2008.

The survey found that net food consumers were losers unless they had jobs with rising wages to compensate for high prices. For the very poor, both urban and rural, obtaining sufficient food is a matter of daily struggle. Making up 20 per cent of the population, these people live "from hand to mouth" as they use their US$2–3 daily income to buy rice and other essential food day by day. About 50 per cent of the households reported cutting back food consumption. This threatens their nutritional status and worsens their health, which may result in lasting adverse impacts. The largest proportion of food insecure people was found in Tonle Sap, plains, and plateau zones. During the lean season, the number of food insecure individuals could increase significantly to about 2.8 million. Using the WFP's definition, the survey found that 12 per cent of households, about 1.7 million individuals, were food insecure and most affected by high food prices at the time of the survey. About one million more people were at the borderline of food insecurity and needed attention as well.

Fortunately, wages from day labour, which are the main income source of the landless and land poor, increased by about 50 per cent in 2008 compared to the previous year. This market-based wage adjustment kept many in the status quo throughout 2008, not falling into destitution as might be expected. Nevertheless, some households were unable to generate higher income due to a lack of employment in their locality and were therefore hit hard by high food prices. These people tend to be located in the poorest areas, where there is little potential for agricultural production or income generation.

Of particular concern, fishing communities were among those most severely affected. Doubled rice prices by June 2008 pushed fishing households into deeper poverty. Their average daily income declined while their daily expenditure increased. Although the price of their produce was rising, rice accounted for only about 20 per cent of their income and was accompanied by rising costs of inputs, while their catch was smaller.

Many farmers need to borrow more money to meet rising production costs, essentially fertilizer, pesticides, machinery, and labour. Some could obtain loans, mostly at high interest rates, to maintain production. This plus borrowing for consumption put about half the households in debt, which is a worrying sign. Now they could be in trouble as most prices of agricultural products were down, seriously reducing or negating their gross margins. It is imperative for government and development partners to help these people worst hit by the high food prices and subsequently by the negative impact of the global economic downturn.

The global financial and economic crisis has been having a considerable impact on Cambodia. Economic growth in 2009 was forecast in the first quarter of 2009 by the World Bank and IMF to be –1 per cent and –0.5 per cent respectively. In light of more recent information in the last quarter of 2009, they revised the figures to –2.75 per cent and –2.2 per cent respectively. The recent impact has proven the vulnerability of the Cambodian economy that has been heavily reliant on external demand, markets, and capital with a weaker domestic orientation. Even though the RGC has employed sound macroeconomic management policies, the economy could not escape from the global economic downturn. The leading industry, garment manufacturing, exported 27 per cent less in the first four months of 2009 compared to the same period last year. Much FDI and construction was put on hold, and fewer tourists travelled to visit Cambodia. Only agriculture is expected to continue growing by about 5 per cent in "real terms", but in nominal terms farmers will receive less income due to the decline in prices. Many farmers have already incurred high production costs in 2008, and therefore have generated negative net returns and some have fallen in debt.

In the past eight months 63,000 workers in the leading garment industry and thousands in tourism and construction services have been laid off. The crisis has also resulted in a drastic fall in the property market and FDI projects and the catastrophic drop in prices of selected cash crops. This has caused spending multipliers to decline. As a result, the national economy has been facing sluggish demand and consumption. Rural households that depend on farming income and remittances from Phnom Penh are suffering the most. Villagers that depend on forest products or growing cassava and the

landless that depend on casual labour are amongst the groups most affected by the economic downturn in Cambodia. A large number of households may have to dispose of productive assets in order to repay their debts, most of which were incurred during the rising farming costs in 2008 and amid expected income from the high prices of crops and land. As a result, the well-being of children, the poor, and near poor, both men and women, has likely deteriorated. Their situation will only get worse in the near future as the annual lean period of July–October is imminent.

Recommendations

The World Bank (2009) has put forward three main messages for sustaining growth in Cambodia. Firstly, the economic growth of the past decade is unlikely to be sustainable in its current form. Secondly, with a focused growth strategy to increase competitiveness and diversify the economy, Cambodia can achieve sustainable growth. Thirdly, Cambodia is blessed with three important opportunities: harnessing regional integration; managing natural resources in a sustainable way; and investing in its future (through agriculture, infrastructure, education, and higher savings).

UNDP (2009) reveals that Cambodia's competitiveness indicators are amongst the lowest in the region in many fields, including skills and human resources, technology, infrastructure, regulations, and institutions. The study recommends that in addition to improvement in these areas, a new set of policies is required to consolidate growth in agriculture, the garment industry, tourism, and construction. These include embarking on a more proactive human resource development policy, a more targeted approach in industrial and investment policy (rethinking the Special Economic Zones, or SEZs), a targeted infrastructure policy, and reducing corruption (UNDP 2009).

It is crucially important to transform Cambodia's private sector, which is still characterized by the overwhelming presence of micro-enterprises, mostly informal. Micro-enterprises employing 1 to 10 people accounted for 97 per cent of the 63,507 firms counted in the census commissioned by the International Finance Corporation and the Asia Foundation in 2008. The official nationwide Establishment Listing of Cambodia from 9 February to 8 March 2009 conducted by the National Institute of Statistics (NIS) found 375,095 establishments in the whole country. Wage employment accounts for only 20 per cent of total employment.

Owing to efforts by the RGC and external development partners, Cambodia has a large body of pro-poor social assistance projects that have

already been mitigating the negative impact of the high food prices as well as the recent impact of the global economic downturn. These projects are, however, too small in financial terms and in geographical coverage. Smart stimulus interventions should be scaling up these projects. For example, ongoing projects to provide assistance to the poor by providing free food rations, quality rice seeds and fertilizer, food for work and cash for work, could be prolonged and scaled up. These projects can be used to improve productivity now and in the long term. Existing projects that could be scaled-up include food for work, which not only provides necessary nutritional intake to the poor but also results in basic rural infrastructure being built for poor communities; school feeding and scholarships for poor communities and households could be expanded for better national coverage; projects to retrain laid-off workers implemented by the Ministry of Labour and Vocational Training; loans to rice millers to expand their capacity in storage, processing, and exporting; agricultural extension department to hire more extension workers to benefit smallholders.

In addition to these short- and medium-term activities, selected structural reforms which will result in immediate benefits for mitigating the impact and lead to long lasting equitable development deserve consideration. Three areas of structural reforms are recommended: (1) Land reform in favour of smallholders should be sped up. Small and medium farmers should be issued land titles so that they have secure tenure for their long term investment decisions. There should be more emphasis on pro-poor and sustainable use of land. Providing more land to rural households that are in need of land will contribute to improving the economic base of rural areas and the domestic economy. More equitable distribution of the benefits from large-scale economic land concessions should be promoted. (2) There should be incentives for private businesses, small-medium enterprises, to become formal so that they can gain better access to capital and can achieve faster growth. This entails policies to transform the informal economy to a formal one in line with a quest to improve and strengthen the domestic economy and reduce over reliance on the world economy, which has become more unpredictable. (3) For the leading garment industry to continue to be competitive, there should be sound labour unions. There should be more training for workers to understand what rights they have and avoid being exploited. The unions should be independent and operate within the law. For the interest of the survival and success of the garment industry as well as other emerging industries, politicians should encourage unions to be independent but not have them under their control.

Notes

1. Inflation would have been above 30 per cent during the second quarter of 2008 if the new method of calculating, which gives more weight to food and gasoline, had been used. The revised method or weight was halted until prices came down slightly, resulting in single-digit inflation in early 2009.
2. The poverty rate in 2004 was 34.7 per cent according to the World Bank (2006, p. 3). The World Bank (2009, p. ii) reports 30 per cent based on the national household survey in 2007.
3. One hectare of rice land produces 2.5 tonnes of paddy rice on average. Production costs account for roughly 50 per cent, thus leaving 1.25 tonnes for five people to consume at the average rate of 250 kilograms of paddy per year. Many households sell part of their produce soon after harvest, although the whole produce is not sufficient for a year's consumption, and buy back milled rice in the period leading up to the next harvest.
4. The paper draws on both secondary data and primary data generated by a nationally representative sample survey (CDRI 2008). Analysis of price trends is based on price collection in Phnom Penh and the provinces by the National Institute of Statistics (NIS), the Ministry of Commerce, and the Ministry of Agriculture, Forestry and Fisheries (MAFF). MAFF collects wholesale prices of agricultural commodities and major inputs in various provinces.
5. See for instance, UNDP Cambodia (2009), Word Bank (2009), UNDP (2007), and World Bank (2006).
6. A tracking study has been planned by UNDP and ILO to answer these questions, amongst others.
7. There is a concern that early rains this year might mean drought at the end of the rainy season, which could be devastating to the rice crop, accounting for 7.5 per cent of GDP.
8. Year-on-year inflation in 2006 was 5.1 per cent. By the end of 2007, overall inflation was 10.8 per cent, while the prices of food and beverages were up 21.3 per cent.
9. The study was conducted in response to the chief concern over the impact of the soaring food prices in the first half of 2008 on the poor in Cambodia. The study was jointly sponsored by the United Nations World Food Programme, the United Nations Development Programme, the United Nations Food and Agriculture Organisation, the World Bank, Oxfam America, and the NGO Forum on Cambodia.
10. Some 43 per cent of landowning respondents received their land through inheritance or as gifts from relatives, while the remainder acquired it either through allocation by authorities or through purchase or forest clearance. Around 39 per cent did not have any legal documents proving their ownership of the land. Some had application receipts and some held other documents. Those in plains and coastal areas were more likely to have application receipts or land

titles, while more of those with no documents were from Tonle Sap and the plateau. Although documentation was scarce, almost no respondents reported serious conflict over their possession or use of land.

11. Rice shortage here refers to households that have less milled and paddy rice than the estimated amount needed for household consumption until the next harvest. A new variable is constructed to capture rice shortage using the following formula: rice sufficiency = amount of milled rice + 0.6 × amount of paddy rice – number of months till next harvest × amount of rice needed per month. Those households that have negative rice sufficiency are considered at risk of food shortage.

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11

DO THE WORLD ENERGY PRICE SHOCKS EXPLAIN THAILAND'S RICE PRICE TURMOIL?

Aekapol Chongvilaivan

The resurgence of Thailand's rice crisis in this decade has been a threat of national and international food security — it has been estimated that to date 854 million people in the world are suffering from hunger, and the recent crisis probably propels 100 million more people into drastic starvation and malnourishment. A number of factors account for the rice price uproar. These include US$100-a-barrel oil prices, globalization, export restrictions imposed by the rice-exporting countries like Thailand, Vietnam, and Cambodia, aggressive speculation in commodity futures markets, and rapidly growing demand for food in large developing countries, especially China and India, on top of global warming and climate change that cut back agricultural production around the globe (Trostle 2008). It has been widely argued that the high energy prices were the most significant culprit of the crisis (Kingsbury 2007). The vital impacts of the energy prices on the commodity markets are confirmed by Mitchell (1987) and Sarris (1990) whose simulations predict that the oil price shocks contribute about 50 per cent to the commodity price variations.[1] However, the roles of energy price shocks in Thailand's rice markets remain unexplored in the literature.

A number of mechanisms account for the energy-rice price relationship, such as surges in costs of rice production, spiraling risk appetites among

investors and speculators, and demand substitution of rice for other grains. "But no factor gets more consistent credit for food price turmoil than the international bio-fuels stampede" (Cocoran 2008). In the context of Thailand's rice production, the biofuel subsidy programmes put upward pressure on rice prices even though there are no such programmes that specifically targeted rice production. The reason is that the programmes essentially provide incentives for agro-fuels production, such as sugar cane, tapioca, and palm oil, thereby wiping out arable land for rice farming.

Analyses of commodity price adjustments and commodity market stability are not new in the literature. Deaton (1992), Leon and Soto (1995), and Sarris (2000) among others examine the dynamic price adjustment structures of many commodities — wheat, rice, and maize. They find rather consistent results that the commodity markets are unlikely to perpetuate the production shocks, but the shocks may take considerable time to vanish.[2] These shed further light on policy implications of agricultural development and food security. Nonetheless, neither of them contemplates the price adjustment behaviours of the commodity markets in the face of energy price shocks.[3]

This chapter attempts to address three questions. First, is there a long-run relationship between the world energy prices and Thailand's rice prices? Second, how does Thailand's rice market respond to energy price shocks? And third, do shocks to Thailand's rice markets leave lasting effects on their rice prices? Answering these questions is essential in that the absence of understanding dynamic adjustments of Thailand's rice markets amid the energy price and other external shocks makes effective formulation and evaluation of the appropriate rice policies implausible.

Using the monthly time series data of Thailand's rice prices and the world energy prices, I developed an empirical framework based on the co-integration analysis.[4] My empirical results show that there exists a long-run relationship between the world energy prices and Thailand's rice prices, and thus the current increases in the energy prices can explain Thailand's rice crisis at least in the long run. In the short run, Thailand's rice markets are irresponsive to the energy price shocks — that is, the rice prices will not immediately respond to the energy price shocks. This may be explained by a time lag of rice production and consumption embodied in Thailand's rice markets. The established Error Correction Mechanism (ECM) further reveals that the shocks to Thailand's rice markets leave merely transitory effects on rice prices — the effects of a shock tend to automatically dissipate, and the rice prices revert to the long-run trend over time. To the best of my knowledge, this chapter is the first to examine the impacts of energy price and other shocks on the price adjustment behaviours of the rice markets in the context of Thailand.

The organization of this chapter can be briefly outlined as follows. The next section discusses the relationship between Thailand's rice prices and the world energy prices. It is followed by a description of the details of the data sources and empirical methodology. After that, I present my empirical results and analyses. The chapter closes with policy implications.

TRENDS OF THAILAND'S RICE PRICE AND THE WORLD ENERGY CRISIS

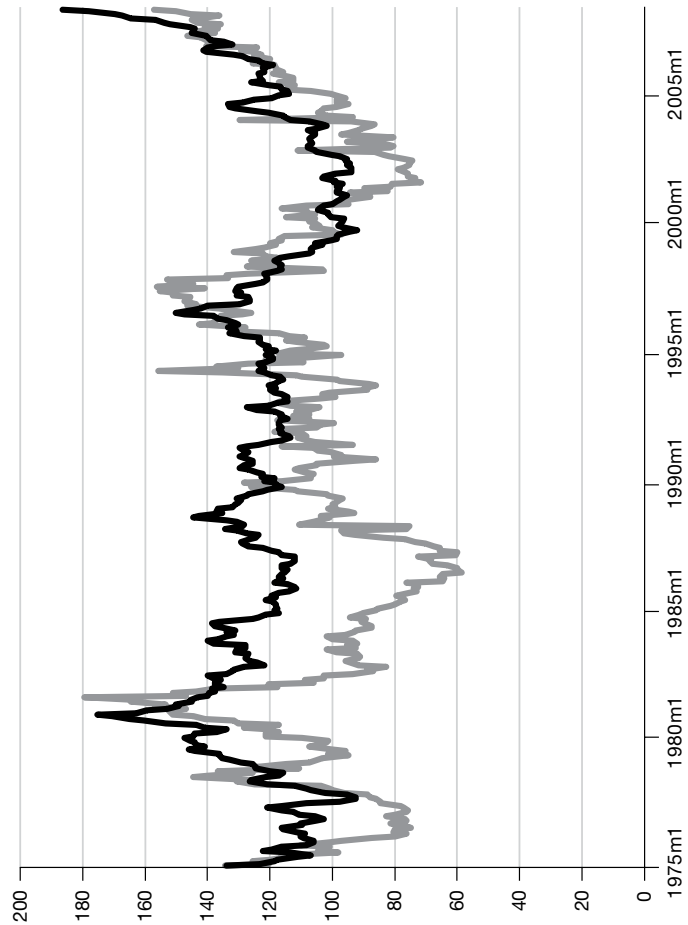
Thailand's rice markets have experienced remarkable changes in their fundamental economic and external conditions — the Green Revolution in the 1970s, advancement of agricultural technology, trade liberalization, and industrialization (Goss and Burch 2001). Rice production has played a significant role in Thailand's economic development; however, the relationship between Thailand's rice markets and the external production shocks, i.e., the world energy price shocks, remains unexplored in the literature.

Figure 11.1 portrays the monthly time trends of Thailand's rice prices and the world food prices from January 1975 to January 2008. It exhibits the boom-to-bust cycles and indicates a strong correlation between Thailand's rice prices and the world food prices over the past three decades. These suggest that Thai rice farmers were susceptible to the world market and external shocks without recourse to government support.[5] Figure 11.1 also highlights the recent food price crisis as reflected from the exponentially increasing trends of Thailand's rice and world prices with the sharp price spikes in 2008. It reveals that Thailand's rice and world food prices have increased more than 80 per cent since 2000. Thailand's position as the world's largest rice exporter and producer implies that the unprecedented hikes in rice prices largely benefitted traders and exporters as opposed to Thai rice farmers.

A number of factors may account for the recent food price turmoil — droughts in many regions around the world, rising food consumption in large developing countries, low grain reserves, and so forth. Among others, the energy price shocks are the most significant factor explaining the rice price variations (Mitchell 1987).

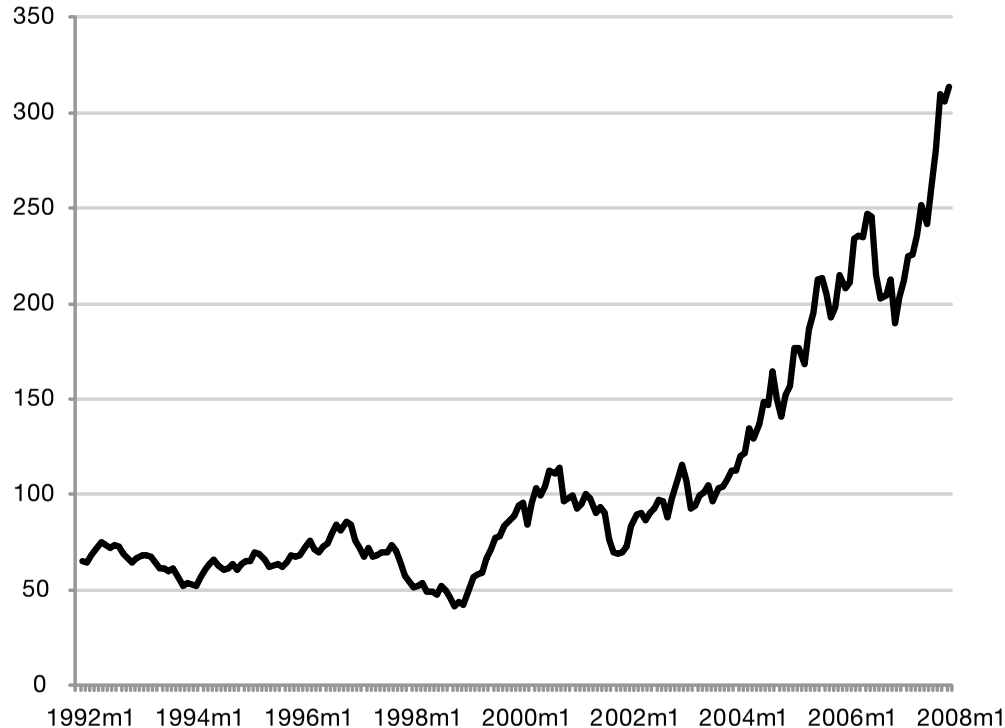
Figure 11.2 shows the time trend of the world energy prices from February 1992 to January 2008. The world energy prices were relatively stable during the early 1990s. However, they had increased six-fold since the late 1990s. Interestingly, Figures 11.1 and 11.2 suggest that the energy price shocks did not affect Thailand's rice markets immediately. There is a time lag between the world energy price crisis and Thailand's rice price crisis — the former appeared after the late 1990s, whereas the latter inaugurated five years thereafter.

FIGURE 11.1
Thailand's Rice Price and the World Food Price Indices (2000 = 100)



Source: *International Financial Statistics* (various issues).

FIGURE 11.2
The World Energy Price Index (2000 = 100)



Source: *International Financial Statistics* (various issues).

One of the reasons why rice production costs are highly correlated with energy prices is that Thailand's corporate farming is petroleum-intensive — it relies heavily on petroleum-based fertilizers, farm equipment, and transportation. To tackle this problem, policymakers should promote the adoption of energy-saving, environmentally friendly farming and fertilizing alternatives, e.g., recycling animal and vegetable waste, among Thai farmers.

Monopolization in Thailand's rice markets is another threat that induces investors and speculators to hedge against increases in commodity prices triggered by energy price shocks. The solution to excessive hoarding and speculations destabilizing the markets is straightforward — to promote competition in the rice trade system. For the time being, a few companies have dominated Thailand's rice trade system and thus extract surpluses of soaring rice prices from Thai farmers. The problem, however, seems exacerbated by the Thai Government's plan to influence the rice markets by establishing a cartel in the same way as the Organization of the Petroleum Exporting Countries (OPEC) (Fuller 2008).

Therefore, it may be interesting to empirically investigate short- and long-run linkages between the world energy prices and Thailand's rice markets. I also attempt to develop a framework that reveals how Thailand's rice markets respond to the world energy price and other temporary shocks. My preliminary figures showing the time trends of Thailand's rice and world energy prices may provide a hypothesis that there are such linkages, at least in long run.

DATA

This chapter employs monthly data on Thailand's rice prices and the world energy prices, retrieved primarily from *International Financial Statistics (IFS)*, International Monetary Fund (IMF). For comparison purposes, both time series variables are reported in terms of indices of unit values at base 2000 = 100. The series are linked by using ratio splicing at the first annual overlap, and the linked series are converted to a common base year 2000 = 100. The index of Thailand's rice prices is available over the period of January 1975 to January 2008, whereas *IFS* reports the index of the world energy prices from February 1992 to January 2008. The limited availability of energy price information prior to February 1992 implies that our empirical analyses developed later in this chapter are pertinent only to the data of rice and energy prices for the period from February 1992 to January 2008. Even though our data limitations substantially confine the number of observations,

my time-series data set which is monthly and spans over fifteen years is still sufficiently long (with 397 observations) to allow the uses of time-series estimation techniques.

EMPIRICAL RESULTS AND ANALYSES

This section is devoted to presentation and analyses of empirical results based on the co-integration analysis. It should be emphasized that my research inquiries into the adjustment behaviour of Thailand's rice market are not straightforward. Their complication of the issues necessitates applications of formal statistical frameworks in which technical issues are the norm rather than the exception. However, these statistical discussions regarding my empirical methodology are beyond the scope of this chapter and therefore relegated to the appendix.

Long-run Analysis

My preliminary statistical examination depicted in the appendix points to a potential problem of spurious regression of Thailand's rice prices on the world's energy price. To develop further analyses, I utilize the Engle-Granger (EG) Test. That is, I perform a linear regression of P_t^{RICE} on $P_t^{WENERGY}$ as in Equation (A1), in the appendix, by using the standard OLS estimation with the heteroskedasticity-robust standard errors and then carry out the DF Test on the predicted residuals.[6]

$$P_t^{PRICE} = \underset{(2.778)}{102.7484^{***}} + \underset{(.018)}{.0975^{***}}\, P_t^{WENERGY} + \hat{\varepsilon}_t$$

No. of Obs. $F = 29.4^{***}$, and $R^2 = .803$

The DF Tests on the level of predicted residuals yield the $|\tau|$ statistics equal to 2.98 with the corresponding MacKinnon approximate p-value of 0.0368. Therefore, the null hypothesis that there is no long-run relationship between Thailand's rice prices (P_t^{RICE}) and the world energy prices ($P_t^{WENERGY}$) can be rejected at the 5 per cent level of significance; that is, they are co-integrated.[7]

Central to my analysis is the co-integrating estimate ($\hat{\beta}_1$). It is positive and statistically significant at 1 per cent ($\hat{\beta}_1 = .0975$). This implies that an increase in the world energy prices results in a hike in Thailand's rice prices. Therefore, the rice price crisis is attributable to the world energy crisis.

There are a number of mechanisms through which higher energy prices entail higher rice prices, at least in long run.

Firstly, an increase in the world energy prices augments costs of rice production in that modern rice production relies heavily on petroleum-based products and petroleum-dependent technology, such as fertilizers, farm equipment, and transportation. The World Bank has reported that the prices of fertilizers were four times higher in mid-2008 than the average for 2006, while the prices of phosphate rock had been skyrocketing seven-fold.

Secondly, the world energy crisis aggravated macroeconomic variables globally as it resulted in stagflation in a number of countries. Collapses of stock markets, two-digit inflation rates, and climbing unemployment rates around the world have lured investors and speculators into rice and other commodities futures markets as a hedge against the fluctuation of commodity prices.

Thirdly, the high energy prices have entailed a consumption-switching effect — people and animals shift their consumption towards rice due to higher prices of other staple grains. This seems plausible given the fact that an energy price jump, to a large extent, has caused shortages and soaring prices of its substitutes, such as wheat, soybeans, and vegetables.

Last but not least, in the context of Thailand's economy, US$100-a-barrel oil has induced Thai farmers to give up rice production and to shift their resources towards agro-fuels production, i.e., sugar cane, tapioca, and palm oil.[8] In this sense, the effects of the world energy price crisis on Thailand's rice price crisis are production-switching — the biofuels craze has taken arable land away from rice production, ultimately resulting in increases in the rice prices. Ironically, the Thai Government's current energy security initiatives seem to exacerbate Thailand's rice crisis as it has attempted to encourage private sector investment in biofuels production. The policies include predetermined ethanol and biodiesel prices; promoting palm oil production and availability of gasohol at petrol stations; and establishing loan schemes for purchases of cassava for gasohol production. Furthermore, in February 2008 the Thai Government imposed national regulations requiring all diesel fuel to have 2 per cent biodiesel and targeted 5 per cent by 2011.

Usual caveats apply. My empirical analyses are pertinent to the relatively short monthly data of the energy prices. As demonstrated by Sumner (2009), examining the short-term pictures of commodity price patterns could be extremely misleading and result in biased conclusions. However, there are at least two reasons why my monthly data set spanning fifteen years from 1992 to 2008 is relevant to my analysis. Firstly, and perhaps most importantly, in the past Thai rice farmers adopted the traditional ways of production such as

natural fertilizers, labour-intensive rice processing, and exploitation of animals rather than machinery. It was only over the past one or two decades that the energy price fluctuations became relevant to their concerns. In addition, even though the fuel cost shares, as a matter of fact, remain relatively low compared to other inputs, the effects of energy price changes on the rice prices, as enumerated earlier, may still be occurring through other mechanisms, particularly speculation in the commodity markets, consumption-switching effects, and biofuels stampedes.

I acknowledge that the extension of the data set that contains the information for the 1970s–80s is by all means indispensable. However, to do so is not feasible at the time of writing and is beyond the scope of this chapter, due to the limitations of monthly energy price data. Therefore, my empirical findings should be deemed as tentative. I leave it for possible avenues of future research.

Short-run Analysis

The discussions thus far are concerned with the long-run relationship between Thailand's rice prices and the world energy prices. The natural questions that may be arising are: (1) How do the world energy prices affect Thailand's rice markets in the short run? And (2) how is the short-run adjustment of Thailand's rice prices in face of shocks? Given my baseline findings that both Thailand's rice prices and the world energy prices are co-integrated,[9] I develop further analyses by establishing the ECM.[10]

$$\Delta P_t^{PRICE} = \underset{(.2934)}{.2934} - \underset{(.0573)}{.0029}\Delta P_t^{OIL} - \underset{(.0314)}{.0917^{***}}\,\hat{\varepsilon}_{t-1} + \hat{u}_t$$

No. of Obs. = 191, $F = 4.42^{**}$, and $R^2 = .0444$

The ECM reveals that the short-run impact of the world energy prices on Thailand's rice prices ($\hat{\alpha}_1$) is not statistically significant. This result is not surprising, however. The rice production is seasonal and is therefore unlikely to immediately respond to energy price shocks, which affect both demand and supply for rice. My result is consistent with Figures 11.1 and 11.2 in the sense that the world energy prices have persistently increased since the late 1990s, but Thailand's rice prices exhibited an increasing trend only after 2002.

Interestingly, the ECM reveals that the fluctuation of Thailand's rice prices amid the shocks — say, the droughts in some regions, such as the Philippines, sub-Saharan Africa, and Australia; the soaring demand from

growing populations in China and India; and the policy distortions in the rice market, such as export restrictions, hoarding and pre-emptive buying, price controls, and subsidies — tend to be short-lived. The negative, statistically significant coefficient of $\hat{\varepsilon}_{t-1}$ implies that the trajectory of Thailand's rice prices is increasing (decreasing) in face of negative (positive) shocks to its rice markets.

The model predictions that the shocks to the rice markets are impermanent are strikingly consistent with Deaton (1992), Leon and Soto (1995), and Sarris (2000), among others. The recent reports also indicate the rice prices have retreated 11.6 per cent right after hitting an all-time high in May 2008 following suspensions and bans of rice exports in a number of rice-exporting countries, including India, Egypt, Vietnam, Brazil, and Indonesia.[11]

CONCLUSIONS AND POLICY IMPLICATIONS

This chapter empirically investigates the impacts of hikes in the world energy prices on Thailand's rice markets, employing a co-integration analysis. The results reveal that Thailand's rice price turmoil is attributable to the soaring world energy price in the long run. The ECM further reveals that Thailand's rice markets in the short run are irresponsive to the world energy price fluctuation; the temporary shocks — global economic recessions, droughts, and export restrictions — to the rice markets are short-lived as they will revert to the long-run trends over time. The impacts of the world energy price shocks on the rice market with time lags suggest that the Thai Government must target long-term agricultural policy such as productivity improvement, infrastructure, and agricultural technology development, in order to make Thai rice farmers immune to the world energy price instability. In the short run, however, any policy interventions such as subsidies, quotas, and other trade-related measures would simply be market distortions that ultimately hurt both consumers and farmers.

There are a number of mechanisms through which hikes in energy prices perturb Thailand's rice markets, at least in the long run: increasing costs of rice production spurring speculation in the rice markets, shifting rice demands via the consumption-switching effects, and entailing international biofuels stampedes.

A sharp increase in the prices of some commodities may bring about the consumption-switching effects on rice. The Thai Government therefore should also closely monitor other commodity prices so as to achieve overall food price stability. Food security should not be confined only to some particular commodities. Rather, it should target all commodities as a whole.

This chapter casts doubt on the efficiency of Thailand's current energy security policy, which has attempted to promote the production of agro-fuels, especially palm oil, sugar cane, and tapioca, which go to the production of ethanol and biodiesel. Thousands of acres of arable land in Thailand have been shifted from rice production to agro-fuels production. It has recently been estimated that the world energy price crisis that triggered the biofuels craze all over the world accounts for 75 per cent of increases in global food prices, and has contributed most significantly to Thailand's rice crisis. This implies that Thai leaders are achieving energy security at the expense of food security.

The resurgence of energy price crises should redirect energy security policy towards the development and adoption of energy-saving technology, such as solar panels, wind turbines, and biomass, instead of biofuel alternatives which exacerbate food shortages around the world.

In a nutshell, my empirical exercise calls for a new phase of policy that insulates Thailand's rice markets from energy price shocks; otherwise, millions of Thai poor are going to end up in drastic hunger despite the fact that Thailand is the world's largest rice producer.

APPENDIX

My empirical framework employed throughout this chapter builds upon a well-established co-integration analysis. It serves as a key tool to examine the extent to which the world energy price crisis explains Thailand's rice price havoc. I propose the simplest econometric model as follows:

$$P_t^{PRICE} = \beta_0 + \beta_1 P_t^{WENERGY} + \varepsilon_t, \quad \text{(A1)}$$

where P_t^{PRICE} is Thailand's rice price index; $P_t^{WENERGY}$ is the world energy price index; and ε_t is an error term. It should also be highlighted that I employ Thailand's rice price index instead of its production index in that the former captures the price effect of energy price shocks and therefore better reflects the effects of soaring energy prices on both consumption and production of rice. My hypothesis is motivated by an idea that if the world energy crisis causes a rice price crisis in Thailand, the world energy prices will be positively correlated with Thailand's rice prices.

Although the model estimation is straightforward, the validity of the results is not. As is well known, a regression of a time series variable on another time series variable may be spurious — no meaningful, though statistically significant, relationship between the two variables. The test whether Thailand's

rice prices and the world energy prices are co-integrated or have a long-run relationship, is based on the Engle-Granger (EG) Test, first introduced by Engle and Granger (1987).

The procedure of the EG test can be briefly summarized as follows: Firstly, I employ the Dickey-Fuller (DF) Test to see whether Thailand's rice prices (P_t^{PRICE}) and the world energy prices ($P_t^{WENERGY}$) are individually non-stationary. The DF Test produces a $|\tau|$ statistic with respect to the null hypothesis that a time series variable is non-stationary. If they are non-stationary, it is possible that a regression in Equation A1 is spurious — the parameter estimates based on Equation A1 will converge to zero asymptotically and hence even have no asymptotic distribution. Secondly, I obtain the co-integrating coefficient ($\hat{\beta}_1$) and the predicted residuals ($\hat{\varepsilon}_t$) by employing the standard ordinary least squares estimation with a heteroskedasticity-robust procedure. Lastly, I perform the DF Test on the residuals. If the residuals are stationary, I can conclude that both variables, though non-stationary, are co-integrated — there exists a long-run relationship between Thailand's rice prices and the world energy prices.

Furthermore, it may be interesting to empirically investigate short-run price adjustments in Thailand's rice markets. It reveals how Thailand's rice markets adjust to the long-run trends facing shocks such as sudden changes in demand and cyclical supply shocks. In so doing, I establish the Error Correction Mechanism (ECM), given that Thailand's rice prices and the world energy prices are co-integrated. Specifically, the ECM takes the following form:

$$\Delta P_t^{PRICE} = \alpha_0 + \alpha_1 \Delta P_t^{WENERGY} - \alpha_2 \hat{\varepsilon}_{t-1} + u_t, \qquad \text{(A2)}$$

where $\hat{\varepsilon}_{t-1} = P_{t-1}^{RICE} - \hat{\beta}_0 - \hat{\beta}_1 P_t^{WENERGY}$, and u_t and is the error term. α_1 captures the short-run relationship between Thailand's rice prices and the world energy prices, and α_2 reflects the dynamic adjustments of the rice prices. The effects of shocks die down over time — that is, the rice prices are converged to the long-run trends — only when α_2 is negative.

Table 11.1 reports the statistics when the DF Tests are carried out based on both level and first difference of Thailand's rice price (P_t^{PRICE}) and the world energy price indices ($P_t^{WENERGY}$). The results show that the null hypothesis of non-stationary time series can be rejected only for $P_t^{WENERGY}$ because the $|\tau|$ statistic corresponding to the level of P_t^{PRICE} is statistically significant at the 5 per cent level of significance, whereas that of $P_t^{WENERGY}$ is not. The DF Test on the first difference of $P_t^{WENERGY}$ further reveals that it is integrated of order 1. Accordingly, my results cast doubt on the spurious relationship between Thailand's rice prices and the world energy prices and call for the

TABLE 11.1
The Dickey-Fuller (DF) Test and the Corresponding |τ| Statistics

Variables	Level	First-Differenced
P_t^{PRICE}	3.391 (.0113)	25.854 (.0000)
$P_t^{WENERGY}$	2.458 (.9990)	12.401 (.0000)

Note: The DF Test is based on a random walk without drifts and deterministic trends. The MacKinnon approximate p-values are in parentheses.
Source: Estimated by the author.

utilization of the co-integration approach to establishing the long- and short-run relationships.[12]

Notes

This chapter benefits from insightful comments and discussions by Richard Barichello, Aris Ananta, and the participants at the 33rd Federation of ASEAN Economic Associations (FAEA) Conference, Vietnam.

1. Agricultural policy shocks explain another 25 per cent; only about 20–30 per cent is due to unexplained factors, i.e., bad weather and incorrect model specifications.
2. In other words, the commodity price is not random walk (non-stationary) in which random shocks are persistent.
3. Deaton (1992), Leon and Soto (1995), and Sarris (2000) study the stationary property of the commodity prices time series; that is, they test whether the commodity prices are random walk (non-stationary). If they are, the commodity markets tend to perpetuate the effects of shocks. Phrased in another way, the shocks will make the commodity price trajectory deviate from its long-run trend.
4. It should be highlighted that a co-integration analysis is well established as an econometric approach to investigating short- and long-run behaviour of time-series variables. Hence, the methodology developed in this chapter is sufficiently generalized to investigate that of other commodities. One could also easily extend my framework to capture other explanatory factors of Thailand's rice crisis, such as population growth, global warming and climate change, and export restrictions, among others. Additionally, even though my empirical framework developed in this chapter builds mainly upon a statistical approach, the findings are concerned with economic intuitions and, more importantly, have several crucial policy implications on agricultural policy.
5. It is generally accepted that Thai rice farmers are highly vulnerable to structural

changes hitting the markets since Thailand's rice policy aims to generate revenue through diversification of taxable resources and to achieve price stability, rather than equipping them with enough protection against external shocks (Dixon 1999).

6. *** is statistically significant at 1 per cent. Robust standard errors are reported in parentheses.
7. My main results are qualitatively unchanged when the drifts and deterministic trends are incorporated in a random walk process.
8. Ethanol is produced from sugar cane and the remainder of tapioca, while palm oil can be used to produce biodiesel.
9. The Granger Representation Theorem states that if two time series variables are co-integrated, then the relationship between the two can be established as the ECM.
10. ** is statistically significant at 5 per cent. *** is statistically significant at 1 per cent. Robust standard errors are reported in parentheses.
11. See <http://www.marketoracle.co.uk/Article4561.html> for further information.
12. My results are robust with respect to inclusion of drifts and deterministic trends in a random walk.

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12

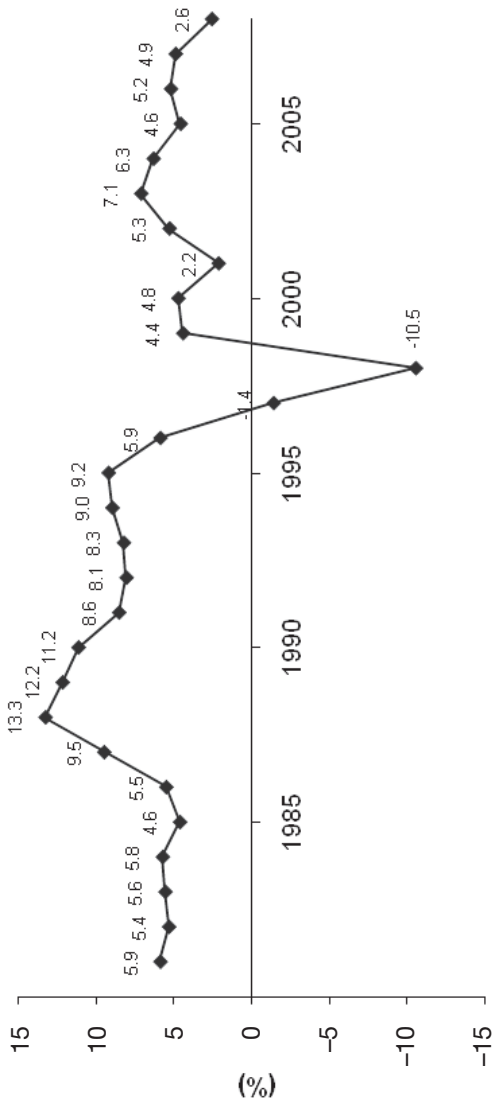
IMPACT OF THE 1997–98 FINANCIAL CRISIS ON EMPLOYMENT, MIGRATION, AND POVERTY
Lessons Learnt from Thailand

Sawarai Boonyamanond and
Sureeporn Punpuing

Prior to 1997, Thailand had been regarded as one of the rapidly developing nations among its developing country counterparts and was seen as likely to become the fifth Tiger of Asia, following in the steps of the highly industrialized economies of Hong Kong, South Korea, Singapore, and Taiwan. Thailand's miracle growth performance was illustrated by the exceptionally high GDP growth rate during the mid-1980s and the early 1990s, the era during which the Thai economy grew about 8.5 per cent per year on average and reached 13.3 per cent in 1988. It was not until 1997, when the Asian financial crisis began, that GDP growth drastically slumped to its lowest point of –10.5 in 1998 (Figure 12.1). All economic sectors were severely affected, but with tireless effort and numerous actions, Thailand slowly began its recovery a few years later.

The collapse of financial institutions in the United States and Europe and the resulting recession and economic downturn in 2008 spread to other

FIGURE 12.1
Growth Rate of Real GDP, 1981–2008



Source: Office of the National Economic and Social Development Board (2009*a*).

regions and turned into a global crisis. Thailand, which relies heavily on the export sector, has inevitably been affected. In addition to the global recession, political instability within the country and frequent changes of government since 2006 have further aggravated the economic situation. As a result, the country's overall economic performance rapidly contracted from 5.2 per cent in 2006 to 4.9 per cent in 2007 and ultimately to 2.6 per cent in 2008. Particularly in the last quarter of 2008, the decline in exports of goods and services and the contraction of tourism unexpectedly and drastically dampened Thai economic growth to –4.2 per cent, which continued to drop further to –7.1 per cent before rising to –4.9 per cent, in the first and second quarters of 2009, respectively (Figure 12.2).

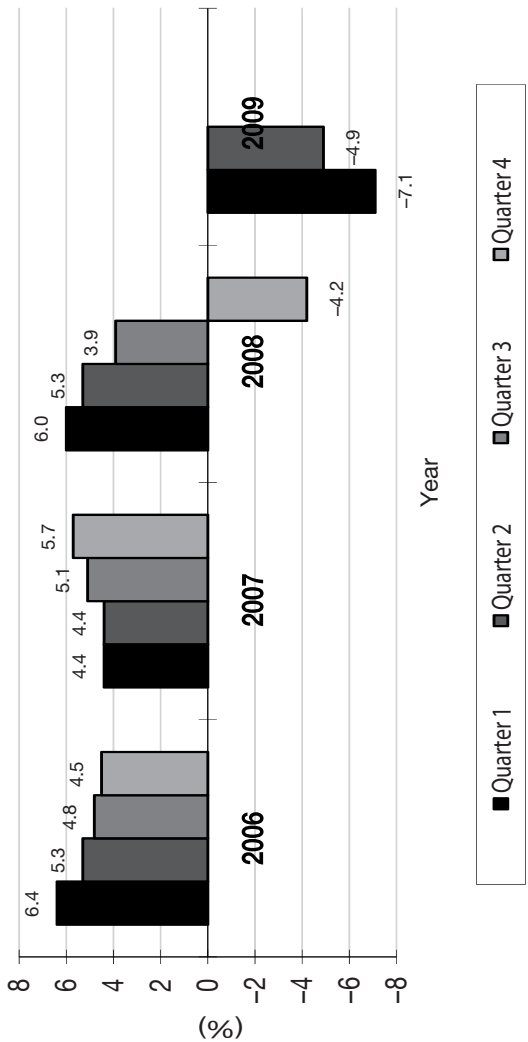
In the midst of such an economic meltdown, the government's ability to take effective action would help mitigate negative consequences on the overall economy. This study therefore attempts to re-examine lessons learnt from the previous financial crisis in Thailand by assessing the impact on the labour market that occurred at that time. Of particular interest are the problems of rising unemployment, the mobility of people, and changes in their working conditions and well-being. The results of this study hopefully can build awareness and give some guidance on how to design effective policies that can lessen adverse economic impacts that might arise from the current global financial crisis.

CAUSES OF THE ASIAN FINANCIAL CRISIS

Prior to the burst of the bubble economy in 1997, the Thai economy had done extremely well. The impressive economic growth was attributed mostly to export-oriented policies that emphasized manufacturing and the service sector. In the early 1990s, Thailand's financial system was liberalized, as indicated by the establishment of the Bangkok International Banking Facility to assist international lending and borrowing. While the high interest rates and high profit margins attracted massive capital flows from abroad, the new access to such relatively cheaper foreign loans allowed Thai enterprises to borrow and invest extensively. However, the premature liberalization of financial institutions without prudential regulation, together with the currency exchange rate that was kept rigid, encouraged even more foreign capital to flow into speculative sectors such as real estate and the stock market rather than into more productive sectors (Kittiprapas and Intaravitak 2000).

The demise of the erstwhile remarkable Thai economic performance started to manifest itself with a rapidly increased foreign debt burden,

FIGURE 12.2
Quarterly Growth Rate of Real GDP, 2006–09



Source: Office of the National Economic and Social Development Board (2009*b*).

overconsumption, and excessive investments in unproductive sectors leading to large current account deficits, the loss of investment confidence, and corresponding capital flight. In addition, partly due to the higher inflation rate in Thailand compared to its trading partners and the corresponding rise in the real effective exchange rate, manufacturing began to lose its competitiveness and export growth suddenly fell to negative or very low levels in mid-1996 (Siamwalla and Sobchokchai 1998). The Thai baht was then subjected to heavy speculative attacks. The Bank of Thailand tried to defend the currency, but this eventually depleted foreign reserves, thus forcing the Bank to float the exchange rate on 2 July 1997. The sudden baht depreciation and the financial turmoil that followed led the country to seek financial help from the International Monetary Fund under strict conditions to rebuild economic stability.

Ten years after the Asian financial turmoil, another financial crisis erupted, but this time it started in developed countries — the United States and European countries. Even though the crises were a decade apart, they shared some common features in the sense they were caused mainly by problems in the real estate, banking, and credit sectors.

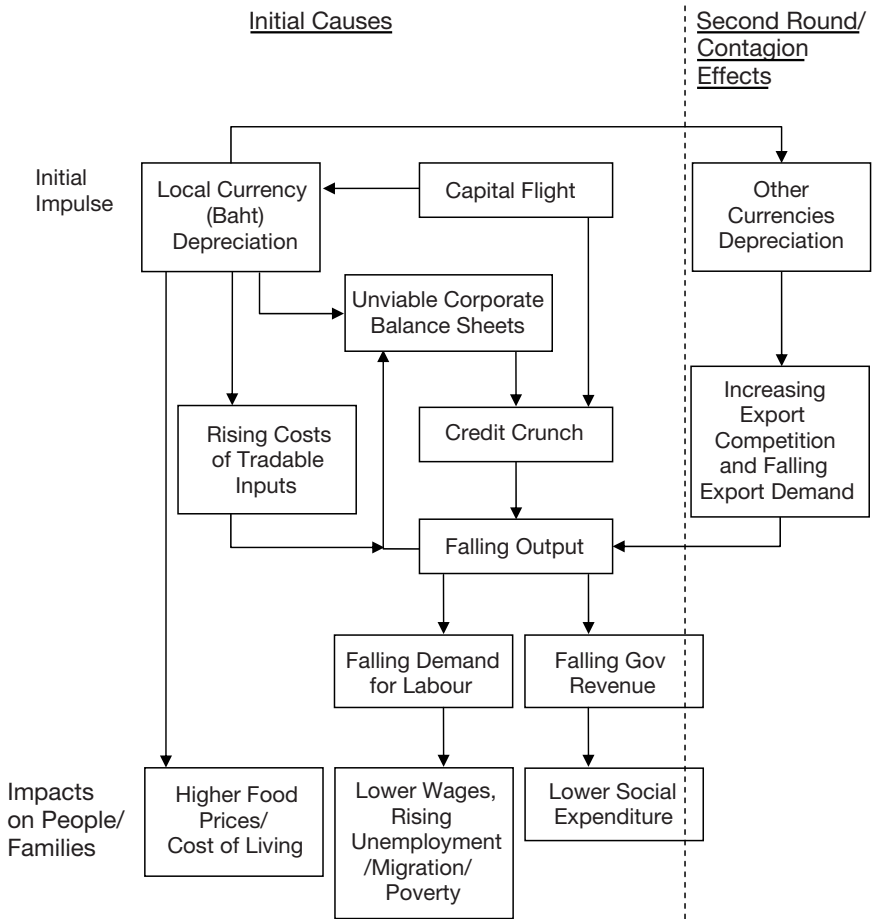
LINKS FROM THE ASIAN FINANCIAL CRISIS TO THE ECONOMY

To clearly assess the impacts of the 1997–98 crisis, it is important to understand the ways in which the financial crisis adversely affected the real economic sector as simply illustrated in Figure 12.3.

Triggered by the aforementioned problems within the country, a large portion of short-term capital inflows turned into massive capital outflows overnight. The corresponding depreciation of the Thai currency immediately worsened the financial position of all corporations, both small and large, especially those that borrowed in foreign currencies, because their external debt repayments increased dramatically. The banking sector was overwhelmed with problems of non-performing loans and lack of liquidity. Many financial institutions had to close down, the financial system eventually collapsed, and the whole economy faced a severe credit crunch.

The meltdown of the financial sector in Thailand carried over into the real sector and brought about a rapid contraction in domestic demand. This led to reductions in production, the demand for labour, and government revenue, all of which consequently affected individuals or households in terms of unemployment, wage cuts, and lower budgets for social expenditure (Sussangkarn, Flatters, and Kittiprapas 1999).

FIGURE 12.3
Repercussions of the Asian Financial Crisis



Source: Sussangkarn, Flatters, and Kittiprapas (1999), Figure 1.

By and large, currency depreciation would be expected to fuel economic growth because the trading sector would receive higher income in terms of local currency from its trades; however, this did not happen in Thailand in 1997–98. According to Kittiprapas (1999), this was mainly due to the economic structure that shifted away from labour-intensive into capital-intensive manufacturing, most of which relied heavily on imported content, as well as difficulties in accessing credit and debt management faced by industrial and business

operations. In addition, the financial crisis, first ignited in Thailand and then quickly spread throughout Asia, had caused not only the depreciation in the Thai baht but also of other currencies. The increased export competition in the world market, together with the decreased demand for Thai exports, further lowered production as well as income levels in Thailand.

LABOUR MARKET RESPONSE

This section investigates how the labour market responded to the financial crisis and sharply decreased aggregate demand. It focuses on unemployment and labour force participation. The analysis is based on a national representative survey — the Labour Force Survey — conducted regularly by the National Statistical Office, Thailand. The first round in February and the third round in August are of particular interest because they were conducted in the dry season and in the wet season of agricultural activities, respectively. Table 12.1 displays some indicators reflecting the overall adjustment of the Thai labour market before and after the crisis.

Unemployment

During 1997 and 1998, when the Thai economy was seriously hit, the structure of the Thai labour market changed from one of labour scarcity to labour surplus (Kittiprapas and Intaravitak 2000). The effect of the financial crisis on the labour market could be gauged by the overall worsening employment situation during this period.

"Unemployed persons" refers to the proportion of the labour force who during the survey week did not work even for an hour, had no jobs, business enterprises, or farms of their own, but who were actively looking for work or available for work. However, those who waited for the appropriate season in order to work were categorized as a "seasonally inactive labour force". It should be noted that, prior to 2001, the total labour force was defined as the population aged 13 years and over who were either currently employed or unemployed as well as seasonally inactive, but from 2001 the age was raised to 15 years and over.

As indicated in Table 12.1, the number of unemployed persons in February (dry season) 1998 reached almost 1.5 million, which was more than double the number for 1997. The rise in unemployed persons was even sharper in August (wet season — the peak of the agricultural season). There were about 1.1 million unemployed persons in August 1998, four times the number in August 1997.

TABLE 12.1
Labour Force Status, 1994–2009
(Unit: thousand)

Labour force status	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*
Dry season (February)																
Total population	**59,034.9**	**59,112.9**	**59,750.4**	**60,350.6**	**60,949.0**	**61,551.2**	**62,192.1**	**62,741.1**	**63,261.2**	**63,795.0**	**64,757.4**	**65,265.1**	**65,103.3**	**65,566.4**	**66,022.0**	**66,715.4**
Total labour force	31,049.9	31,347.9	31,898.4	32,000.2	32,143.1	32,810.2	32,994.3	33,211.9	33,495.0	34,077.0	34,803.2	35,280.2	35,618.6	36,122.1	36,688.3	37,530.0
1. Current labour force	29,447.9	29,778.7	30,740.5	30,964.2	30,892.2	31,740.3	31,838.5	32,027.1	32,851.4	33,731.2	34,423.7	34,938.2	35,304.3	35,839.7	36,425.5	37,282.2
1.1 Employed	28,233.5	29,055.1	30,099.2	30,266.3	29,412.9	30,024.5	30,420.5	30,444.7	31,767.9	32,762.3	33,423.6	34,050.1	34,638.1	35,252.7	35,820.1	36,502.8
1.2 Unemployed	1,244.4	723.5	641.3	697.8	1,479.3	1,715.7	1,418.0	1,582.4	1,083.4	968.9	1,000.1	888.1	666.2	587.1	605.5	779.4
2. Seasonally inactive labour force	1,571.9	1,569.2	1,157.8	1,035.9	1,250.8	1,069.8	1,155.8	1,184.8	643.7	345.8	379.5	342.0	314.4	282.4	262.8	247.8
Persons not in labour force	12,736.9	13,587.7	13,744.5	14,334.9	14,888.6	14,923.8	15,468.1	13,614.4	13,946.7	13,992.3	14,217.8	14,260.8	14,643.0	14,702.1	14,723.7	15,035.3
Persons under 13/15 years of age	15,248.0	14,177.2	14,107.4	14,015.4	13,917.2	13,817.1	13,729.6	15,914.8	15,819.5	15,725.7	15,736.5	15,724.1	14,841.7	14,742.2	14,610.0	14,150.2
Labour force participation rate (%)	**70.9**	**69.8**	**69.9**	**69.1**	**68.3**	**68.7**	**68.1**	**70.9**	**70.6**	**70.9**	**71.0**	**71.2**	**70.9**	**71.1**	**71.4**	**71.4**
Unemployment rate (%)	**4.0**	**2.3**	**2.0**	**2.2**	**4.6**	**5.2**	**4.3**	**4.8**	**3.2**	**2.8**	**2.9**	**2.5**	**1.9**	**1.6**	**1.7**	**2.1**
Underemployement rate (%)	**7.8**	**8.0**	**8.2**	**8.0**	**15.1**	**11.0**	**9.7**	**18.9**	**16.8**	**20.3**	**20.0**	**21.5**	**18.6**	**19.6**	**18.9**	**19.3**
Wet season (August)																
Total population	**59,444.0**	**59,450.8**	**60,045.3**	**60,648.9**	**61,248.4**	**61,856.7**	**62,481.4**	**63,001.1**	**63,526.9**	**64,062.6**	**65,197.2**	**64,884.0**	**65,341.8**	**65,800.1**	**66,511.7**	
Total labour force	32,582.3	33,001.8	32,750.0	33,560.7	33,352.9	33,210.2	33,973.0	34,487.7	34,969.6	35,310.5	36,291.1	36,842.7	36,867.2	37,611.6	38,344.7	
1. Current labour force	32,517.9	32,950.1	32,586.3	33,454.9	33,275.9	33,072.9	33,813.7	34,380.0	34,878.5	35,220.1	36,260.2	36,798.2	36,794.3	37,564.2	38,287.5	
1.1 Employed	32,095.0	32,575.0	32,232.3	33,162.3	32,138.0	32,087.1	33,001.0	33,483.7	34,262.4	34,676.4	35,711.3	36,302.4	36,344.5	37,122.0	37,836.6	
1.2 Unemployed	422.8	375.1	353.9	292.5	1,137.9	985.7	812.6	896.3	616.1	543.7	548.9	495.8	449.9	442.2	450.9	
2. Seasonally inactive labour force	64.4	51.6	163.7	105.7	76.9	137.2	159.3	107.7	91.1	90.4	30.9	44.5	72.8	47.4	57.2	
Persons not in labour force	11,509.5	12,194.1	13,119.4	13,238.0	13,912.9	14,763.7	14,739.1	12,646.7	12,784.9	13,073.3	13,156.3	13,161.6	13,673.7	13,507.1	13,892.8	
Persons under 13/15 years of age	15,352.0	14,254.8	14,175.8	13,850.2	13,982.5	13,882.7	13,769.2	15,866.8	15,772.4	15,678.8	15,749.8	14,879.7	14,801.0	14,681.3	14,274.2	
Labour force participation rate (%)	**73.9**	**73.0**	**71.4**	**71.7**	**70.6**	**69.2**	**69.7**	**73.2**	**73.2**	**73.0**	**73.4**	**73.7**	**72.9**	**73.6**	**73.4**	
Unemployment rate (%)	**1.3**	**1.1**	**1.1**	**0.9**	**3.4**	**3.0**	**2.4**	**2.6**	**1.8**	**1.5**	**1.5**	**1.3**	**1.2**	**1.2**	**1.2**	
Underemployment rate (%)	**7.3**	**7.1**	**7.4**	**13.2**	**9.2**	**10.6**	**9.6**	**13.5**	**12.9**	**13.8**	**14.1**	**15.6**	**15.6**	**16.7**	**14.1**	

Source: Labour Force Survey, National Statistical Office, 1994–2009.

Figure 12.4 shows changes in the percentage of unemployed persons in the total labour force. Unemployment rates increased significantly from their usual low levels. In the dry season, the unemployment rates increased from 2.2 per cent in 1997 to 4.6 per cent in 1998 and peaked at 5.2 per cent in 1999. In the wet season, the rate rose from 0.9 per cent in 1997 to 3.4 per cent in 1998, but started to fall thereafter. Nevertheless, it was not until 2006, a decade after the crisis, that the unemployment rates in both seasons came back down to their previous levels, that is, about 1.9 per cent in the dry season and 1.2 per cent in the wet season.

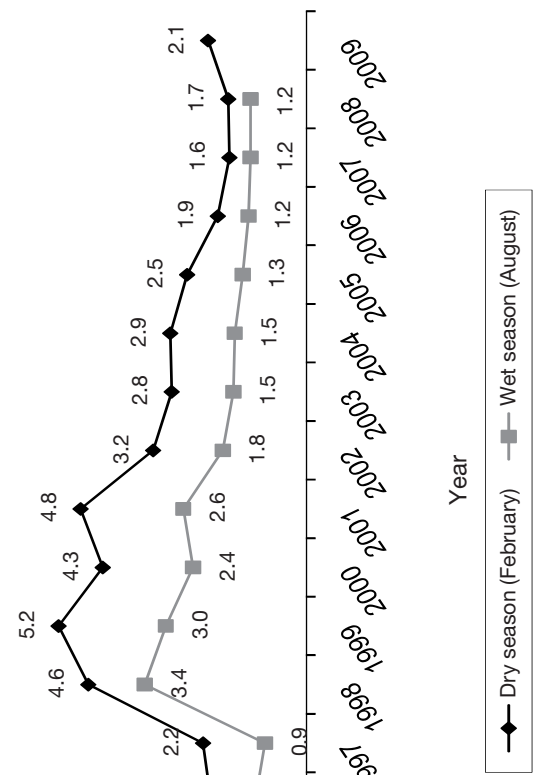
The adverse consequences of the economic turmoil on the labour market seem even more prominent when underemployment is taken into account. The percentage of underemployed persons, which refers to those who work less than 35 hours a week, of the total number of employed persons substantially increased during February 1997 and February 1998 (dry seasons) and in August 1998 and August 1999 (wet seasons), as shown in Table 12.1. It should be noted that data on underemployment before and after 2001 were not strictly comparable due to changes in concepts and definitions.

The considerable differences in the labour force status indicators between the non-agricultural or dry season (in February) and the agricultural or wet season (in August) suggest that this seasonal effect is a prominent feature of labour force activities in Thailand. Any comparison across time thus should be carefully done on a year-to-year basis rather than a round-to-round one (Gray 1999). This study henceforth relies on the wet season surveys conducted in August every year.

When analysing the labour force situation by region, Table 12.2 indicates that, among five regions, Bangkok experienced the worst impact, followed by the Northeastern region. The unemployment rate in Bangkok markedly increased by 3.6 percentage points, from 1 per cent in 1997 to 4.6 per cent in 1998, while that of the Northeast increased by 2.9 percentage points, from 0.7 per cent to 3.6 per cent, during the same period. According to an in-depth study employed by the National Statistical Office in 1998, among 542,000 former employees who became unemployed during January 1997 to July 1998, 26.5 per cent were laid off, 20.7 per cent had worked in establishments that had closed down, and 20.2 per cent resigned because of wage or benefits reductions, or other dissatisfaction with their compensation. Others included those who were ill or injured or who were still waiting to take on new jobs or projects.

Changes in employment in each industry also reflected the uneven impacts of the financial crisis as these were transmitted to the real sectors. As can be seen in Table 12.3, there was a considerable fall of about 1,024,000 persons from August 1997 to August 1998. The negative impact was more severe in the non-agricultural sectors, among which the construction sector accounted

FIGURE 12.4
Unemployment Rate, 1994–2009



Source: Labour Force Survey, National Statistical Office, 1994–2009.

TABLE 12.2
Unemployment Rate by Region, 1994–2008

Region	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*
Whole Kingdom	**1.3**	**1.1**	**1.1**	**0.9**	**3.4**	**3.0**	**2.4**	**2.6**	**1.8**	**1.5**	**1.5**	**1.3**	**1.2**	**1.2**	**1.2**
Bangkok	1.4	0.7	1.3	1.0	4.6	3.8	3.0	3.4	2.4	2.2	2.0	1.9	1.6	1.3	1.3
Central	1.3	1.1	0.8	0.9	2.9	2.2	1.7	2.2	1.6	1.6	1.4	1.5	1.4	1.4	1.4
North	0.7	1.1	0.8	0.8	3.4	2.1	1.6	1.9	1.6	1.6	1.5	1.2	1.0	1.3	1.1
Northeast	1.5	1.3	1.3	0.7	3.6	4.1	3.2	3.2	1.7	1.2	1.3	1.1	1.1	1.0	1.0
South	1.5	1.3	1.1	1.3	2.5	2.1	1.9	2.1	1.8	1.7	1.8	1.4	1.2	1.1	1.3

Source: Labour Force Survey, National Statistical Office, 1994–2008.

TABLE 12.3
Number of Employed Persons by Industry, 1994–2000
(Unit: thousand)

Industry	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*
Total employed	**32,095.0**	**32,575.0**	**32,232.3**	**33,162.3**	**32,138.0**	**32,087.1**	**33,001.0**
Agriculture	17,960.2	16,929.3	16,127.0	16,691.2	16,471.7	15,563.5	**16,095.5**
Manufacturing	3,851.0	4,376.8	4,334.2	4,291.9	4,189.3	4,394.6	**4,784.9**
Construction	1,698.0	1,846.0	2,171.9	2,020.7	1,279.5	1,285.5	**1,280.2**
Commerce	3,617.7	4,094.5	4,341.4	4,601.0	4,463.5	4,736.1	**4,801.5**
Transport	857.9	986.5	953.6	980.3	922.7	989.2	**951.3**
Services	3,859.7	4,121.7	4,094.1	4,342.1	4,584.2	4,892.4	**4,864.9**
Others	249.8	219.7	209.2	234.4	226.2	225.1	**221.7**

Source: Labour Force Survey, National Statistical Office, 1994–2000.

for the greatest loss of employment. That is, the number of construction workers markedly declined by nearly a million, which was equivalent to a contraction of 36.7 per cent from the previous year. The agricultural sector was also affected but only to some extent, which may have resulted from a reduction in large-scale agribusiness and corporate farming. The service sector, on the contrary, was the only sector that gained about 242,000 persons during the same period.

Labour Force Participation

The labour force participation rate is another important indicator that can reveal the situation of the labour market. It is defined as the percentage of the total labour force in the population aged 13 years and over (before 2001) or aged 15 years and over (since 2001). Table 12.1 shows that the labour force participation rate in the wet season gradually declined from 71.7 per cent in 1997 to 69.2 per cent in 1999. A slightly different pattern is seen in the dry season. The rate declined to 68.3 per cent in 1998, but then rose to 68.7 per cent in 1999 before declining again in 2000. Such a declining trend in the labour force participation rate may reflect fewer job opportunities in the market, which may encourage individuals to withdraw from the market completely and turn to household-related activities instead of becoming or remaining unemployed or underemployed.

MIGRATION

Internal Migration

Prior to the crisis, a large number of migrants had moved from rural to urban areas in response to widening regional income disparities that resulted from the rapid development of industrial and service sectors, which were mainly concentrated in Bangkok. Based on the Population and Housing censuses, compiled on a decade basis by the National Statistical Office, there was a net population gain of 365,000 migrants aged five years and over in Bangkok who had moved to Bangkok in the five years preceding the census date in 1990. After Bangkok came the Central region, which had been increasingly attracting migrants from all over the country, especially in the adjacent provinces of Bangkok, namely Nonthaburi, Samut Prakan, Pathum Thani, and Nakhon Pathom. As a result of the government's decentralization policy, first launched in the Fifth National Economic Development Plan (1982–86) to distribute the spillovers from Bangkok to adjacent provinces, it gained almost 300,000 people in the same period. The Northeast, on the other hand, had the largest net outflow of migrants, losing a large number of people, especially to Bangkok and the Central region (Table 12.4).

The collapse of the Thai economy and the deteriorating situation in the labour market that followed not only slowed the trend of resettling around major urban areas but also caused the unusual phenomenon of return migration from urban to rural areas, especially among those in the non-agricultural sectors. Bangkok, the country's main economic catalyst, had experienced a decline in the in-migration stream and a rise in out-migration from the city. During 1995–2000, while Bangkok Metropolis received only 135,000 net migrants aged 5 years and over, the Central region gained 670,000 migrants. The Northeastern region remained as the region with the largest loss of migrants, but the magnitude was much smaller than that in 1990.

In addition, the role of economic factors in determining patterns of migration can also be seen, given that the Ministry of Interior's Centre to Assist People in the Economic Downturn, Department of Local Administration counted the return migrants and found that there were about 188,000 in December 1997. More than half of them went back to the Northeast, and others returned to the Northern, Central, and Southern regions (Table 12.5).

The Labour Force Survey provided more in-depth data on those former workers, categorized by their place of origin and destination, who became unemployed during January 1997 to July 1998 and had migrated during the previous two years. Among 206,000 unemployed migrants, about 48 per cent had moved to the Northeast, 28 per cent to the North, and 13 per cent to

TABLE 12.4
Regional Net Gain/Loss from Five-Year Migration of Population Aged 5 Years and Over

Region of Current Residence	*1965–70*	*1975–80*	*1985–90*	*1995–2000*
Bangkok	64,500	212,300	365,900	134,710
Central	–11,200	–5,800	293,400	670,958
North	–3,200	–23,900	-89,300	–71,627
Northeast	–47,600	–181,300	–553,700	–369,698
South	–2,500	–1,300	–16,300	57,873

Sources: National Statistical Office (1990, 2003).

TABLE 12.5
Return Migrants by Region, December 1997

Region	*Unemployed*		*Return Migrant*	
	Number	*(%)*	*Number*	*(%)*
Central	74,819	7.73	25,493	13.54
North	281,955	29.12	47,075	25.00
Northeast	574,256	59.30	101,413	53.87
South	37,363	3.86	14,283	7.59
Total	**968,393**	**100.00**	**188,264**	**100.00**

Source: Minister of Interior (1998).

the Central region. On average, about two out of five former workers used to live in Bangkok (Table 12.6). These data document the phenomenon of reverse migration from Bangkok to other regions, contrasting to the large migration stream from other areas into Bangkok as normally observed prior to the crisis.

Figure 12.5 indicates that the reasons for migration among unemployed migrants vary by the place of residence during January 1997 to July 1998. In Bangkok, a very large percentage (67 per cent) mentioned "looking for work" for the reason to migrate to Bangkok. This is in contrast to the Northeast region, where a slightly larger percentage (69.4 per cent) mentioned "return home" as the reason for migrating. Similar to the Northeast region was the

TABLE 12.6
Persons Who Became Unemployed during January 1997 to July 1998 and Had Migrated within the Previous Two Years by Places of Origin and Residence

Place of origin	*Place of residence*					
	Bangkok	*Central*	*North*	*Northeast*	*South*	*Total*
Bangkok	935	16,324	24,537	37,515	617	**79,928**
Central	1,579	15,292	17,942	15,518	—	**50,331**
North	2,218	—	11,314	4,505	96	**18,133**
Northeast	—	404	2,594	38,306	—	**41,304**
South	2,327	842	947	992	7,904	**13,012**
Abroad	—	—	1,283	240	245	**1,768**
Unknown	—	716	—	754	97	**1,567**
Total	**7,059**	**33,578**	**58,617**	**97,830**	**8,959**	**206,043**

Source: National Statistical Office (1999).

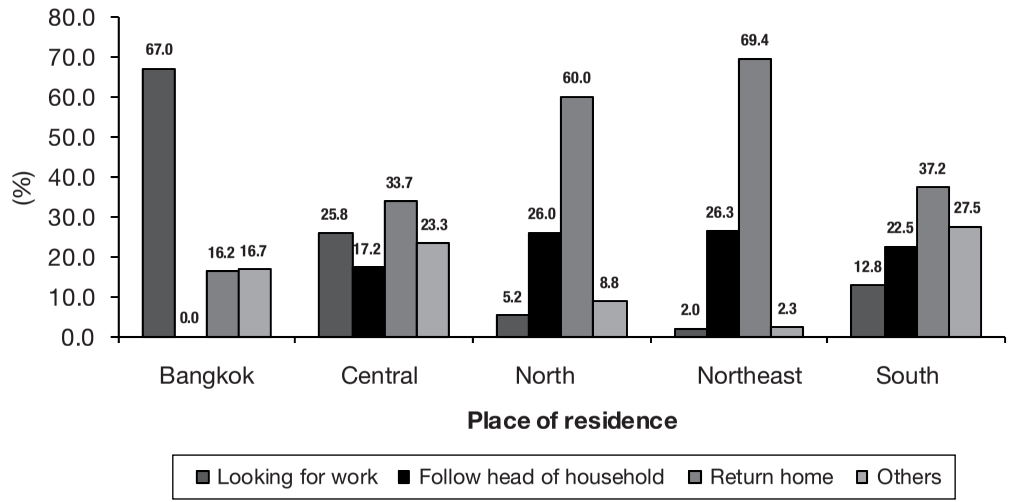
North region. In Central and South regions, the reasons for migration are distributed more equally.

The large percentage of "looking for job" in Bangkok may reflect demand factor, the perceived great economic opportunity in Bangkok. On the other hand, the large percentage of "return home" in the North and Northeast regions may indicate the relative abundance of informal sectors, which can become the safety net for those hit by the crisis in the two regions. Perhaps the migration to these three regions were mostly because of the push factor (hit by the crisis) rather than pull factor (attraction in the destination area).

There may not be too many people migrating out from the South region and, hence, the percentage of "return home" among the unemployed migrants in the South was not very high, though the economy in the South may not be better than those in the North and Northeast regions. The Central region is geographically very close to Bangkok and therefore it shares many similar economic characteristics, but it also has a lot of informal sectors such as found in the other regions. This may explain the relatively equal distribution of reasons for migration to the Central region.

Among unemployed migrants (residing in all regions of Thailand), shown in Table 12.7, the highest levels of unemployment were found among those previously engaged in the non-agricultural sector — 27 per cent were

FIGURE 12.5
Persons Who Became Unemployed during January 1997 to July 1998 and Had Migrated within the Previous Two Years by Reason for Migration and Place of Residence



Source: National Statistical Office (1999).

TABLE 12.7
Persons Who Became Unemployed during January 1997 to July 1998 and Had Migrated within the Previous Two Years by Last Industry, Last Occupation, and Place of Residence

	Place of residence					
	Bangkok	*Central*	*North*	*Northeast*	*South*	*Total*
Last industry						
Agriculture	—	2,124	2,162	29,978	1,123	**35,387**
Non-agriculture	7,059	31,454	56,454	67,852	7,837	**170,656**
Manufacturing	3,153	10,245	10,993	26,401	1,688	**52,480**
Construction	1,579	9,589	21,855	22,109	1,257	**56,389**
Commerce	—	2,209	13,116	5,435	522	**21,282**
Transport	—	2,452	2,165	353	218	**5,188**
Service	2,327	6,884	8,325	13,554	3,009	**34,099**
Others	—	75	—	—	1,143	**1,218**
Total	**7,059**	**33,578**	**58,616**	**97,830**	**8,960**	**206,043**
Last occupation						
Professional	1,147	1,143	2,487	2,324	461	**7,562**
Administrative	—	—	485	1,006	42	**1,533**
Clerical	—	555	8,295	6,023	1,982	**16,855**
Sales	1,180	4,542	9,705	7,474	339	**23,240**
Farmers	—	2,124	2,161	30,070	1,123	**35,478**
Transport	—	2,975	2,461	2,406	422	**8,264**
Craftsmen/ Labourers	4,732	18,440	31,240	40,903	1,637	**96,952**
Service	—	3,799	1,782	7,624	2,954	**16,159**
Total	**7,059**	**33,578**	**58,616**	**97,830**	**8,960**	**206,043**

Source: National Statistical Office (1999).

formerly in construction, and 26 per cent were in manufacturing. In terms of former occupation, the largest portion, which accounted for 47 per cent of unemployed migrants, used to work as craftsmen or labourers. These figures cast further doubt on whether self-employment and family farming in the

agriculture sector can immediately absorb and provide employment for such displaced urban workers, as well as the extent to which underemployment within the sector deepened (Gray 1999; Kittiprapas 1999).

International Migration

In addition to its impact on internal migration, the impact of the crisis on international migration should also be emphasized. Of special interest is the huge flow of irregular immigrants from the neighbouring Greater Mekong Sub-region (GMS) countries. Disparities in the levels of economic and social development as well as the political environments between Thailand and neighbouring GMS countries were the main factors driving international migration flows into Thailand in the early 1990s. Moreover, Thailand's decade of consecutive economic prosperity tightened the labour market, especially during the agricultural peak season, as evidenced by the low unemployment rates. Along with relatively higher educational levels, the attitudes of Thai workers towards menial and low-paying jobs had changed. The country thus had to fulfil such labour shortages with a large influx of low-skilled migrants from neighbouring GMS countries with surplus labourers (Chalamwong 1998*a*). Since the early 1990s, Thailand has been the most popular destination country in Southeast Asia for migrant workers and their families from Myanmar, Cambodia, and the Lao People's Democratic Republic (Sciortino and Punpuing 2009). Yet the expanding international or cross-border migration, for the most part, is undocumented.

Attempting to deal with the problem of a growing undocumented cross-border migration inflow, in 1996 the Thai Government officially launched a periodic registration procedure permitting migrants from only these three neighbouring GMS countries to work temporarily in the country without being deported. Nevertheless, such registered migrants have to abide by certain regulations, such as possessing a work permit, limiting their length of stay, working only in specific economic sectors, and residing only in approved provinces. The registered migration population in the first cabinet resolutions in 1996 was recorded at about 294,000 migrants, accounting for only one third of all estimated irregular migrant workers (Table 12.8).

However, the onset of the crisis in the following years led the Thai Government to implement several measures in an attempt to help Thai workers who had been laid off, and thus reduce unemployment. Policies related to migration included replacing migrant workers with local workers by repatriating undocumented migrant workers, restricting these migrant workers

TABLE 12.8
Number of Registered GMS Migrant Workers in Thailand, by Country of Origin, 1996–2007

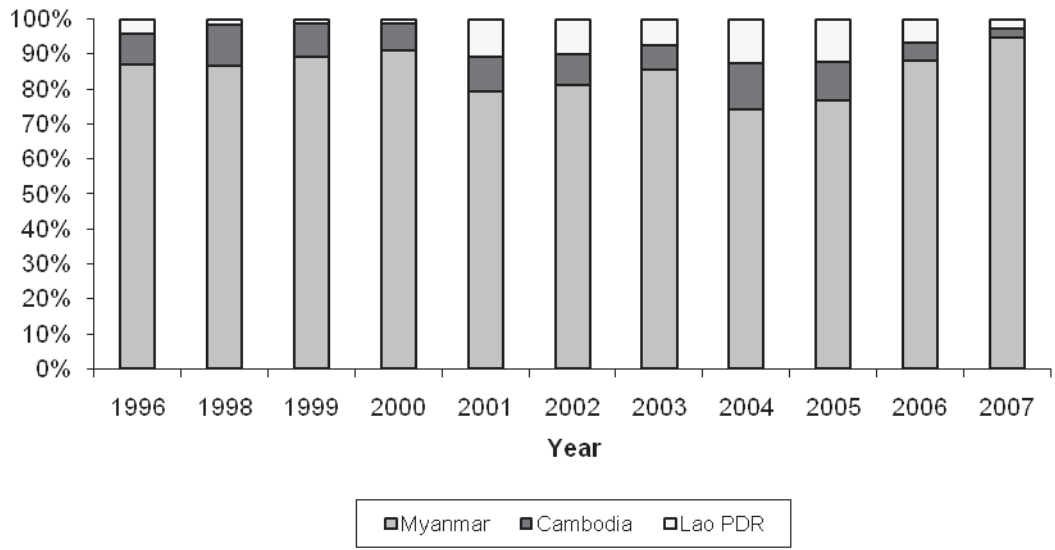
Year	*Myanmar*	*Cambodia*	*Lao PDR*	*Total*
1996	256,492	25,568	11,594	**293,654**
1998	79,057	10,593	1,261	**90,911**
1999	89,318	9,492	1,164	**99,974**
2000	90,724	7,921	1,011	**99,656**
2001	451,335	57,556	59,358	**568,249**
2002	349,264	38,614	42,196	**430,074**
2003	247,791	19,675	21,314	**288,780**
2004	629,260	110,018	105,109	**844,387**
2005	702,915	99,214	111,726	**913,855**
2006	405,379	24,952	29,683	**460,014**
2007	476,676	12,094	12,800	**501,570**

Source: Archavanitkul and Vajanasara (2009).

to fewer border provinces, and limiting the registration for work permits (Chalamwong 1998*b*). A deteriorated economic environment coupled with stringent law enforcement markedly reduced the number of GMS registered migrants by more than threefold in three consecutive years, before the numbers recovered rapidly to almost 570,000 in 2001. It should be noted that, as shown in Figure 12.6, of all neighbouring GMS registered migrants, four out of five were Myanmar nationals. The rest were Cambodian and Laotian. The main occupations in which they were involved were agriculture, construction, fisheries, and domestic work (Archavanitkul and Vajanasara 2009).

The government's policy to push back undocumented migrants and hence create more jobs for millions of unemployed Thai workers is still dubious. This is because, despite the fact that job opportunities did open up, a large number of low-educated local workers preferred staying unemployed to taking those dirty, dangerous, and difficult (3D) jobs previously carried out by unskilled migrant workers. For example, during the 1997 crisis, the 28,000 migrant workers who were laid off in the Central region could be replaced by only 9,900 Thai workers. Similarly, in the Southern region, 22,000 laid-off migrant workers were replaced by only 4,800 Thai workers ("Replacement of Thai Workers" 1998).

FIGURE 12.6
Percentage of Registered GMS Migrant Workers in Thailand, by Country of Origin, 1996–2007



Source: Archavanitkul and Vajanasara (2009).

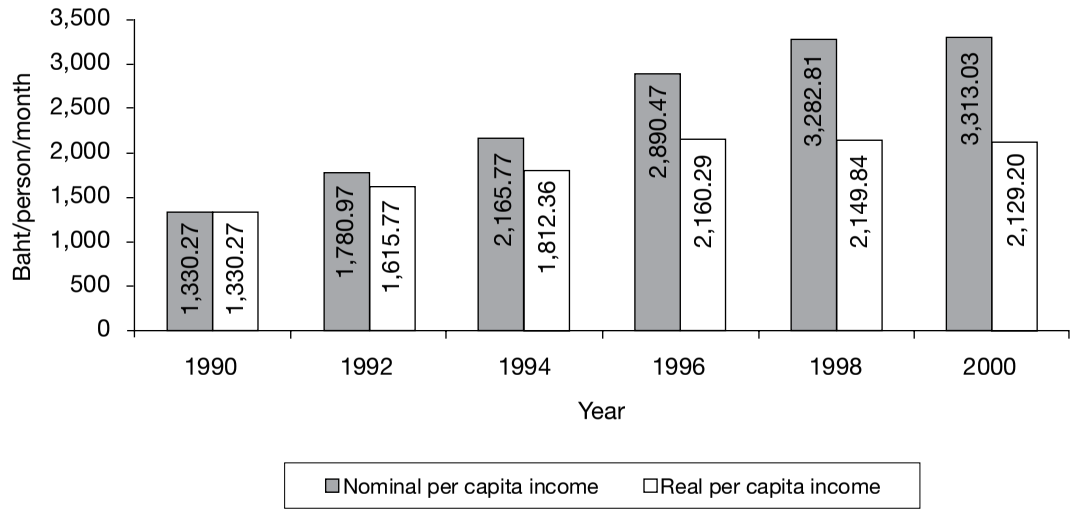
Poverty

During the economic boom, Thailand's impressively high economic growth benefited most Thais. The fruits of growth trickled down to those with very low income levels as evidenced by substantial and widespread reductions in poverty from the 1980s to the early 1990s. However, in mid-1997, when the economy crashed, not only were the prices of basic consumable goods and labour employment higher, but the real income and living conditions of the Thai people also inevitably deteriorated. As shown in Figure 12.7, although average monthly per capita household income gradually rose from 1990 to 2000 in nominal terms, in real terms there was a different trend. Before the crisis, the annual rate of income growth was between 6 and 10 per cent, but after the economic meltdown, it decreased to –0.2 per cent between 1996 and 1998 and further to –0.5 per cent from 1998 to 2000. This section therefore aims to assess the impact of the crisis on poverty among populations of different socio-economic status.

In estimating the extent of poverty in Thailand, a poverty line has been widely used to represent a minimum level of per capita household income or consumption required to maintain an adequate standard of living in a year. Since consumption data closely reflect the standard of living and do not vary much over time, Thailand's official poverty lines thus are constructed based on per capita household consumption, drawn from the 2002 Household Socio-Economic Survey (SES) of the National Statistical Office and adjusted by the Consumer Price Index (Jitsuchon, Phlangpraphan, and Kakwani 2004). Figure 12.8 depicts the per capita consumption poverty lines that show a gradual increase from 633 baht per month in 1988 to 1,443 baht in 2007. One of the most popular measures of poverty incidence is the head count ratio, which refers to the percentage of the population whose per capita expenditure is lower than the poverty line. The poverty head count ratio, as shown in Figure 12.9, drastically declined from 42.21 per cent in 1988 to 14.75 per cent in 1996, before rising to 17.46 per cent in 1998 and 20.98 per cent in 2000, when the impact of the crisis was fully realized. To be more precise, there were more than four million people who were pushed into poverty during 1996–2000. Nevertheless, poverty incidence in Thailand returned to that level prior to the crisis of 15 per cent in 2002 and gradually decreased thereafter.

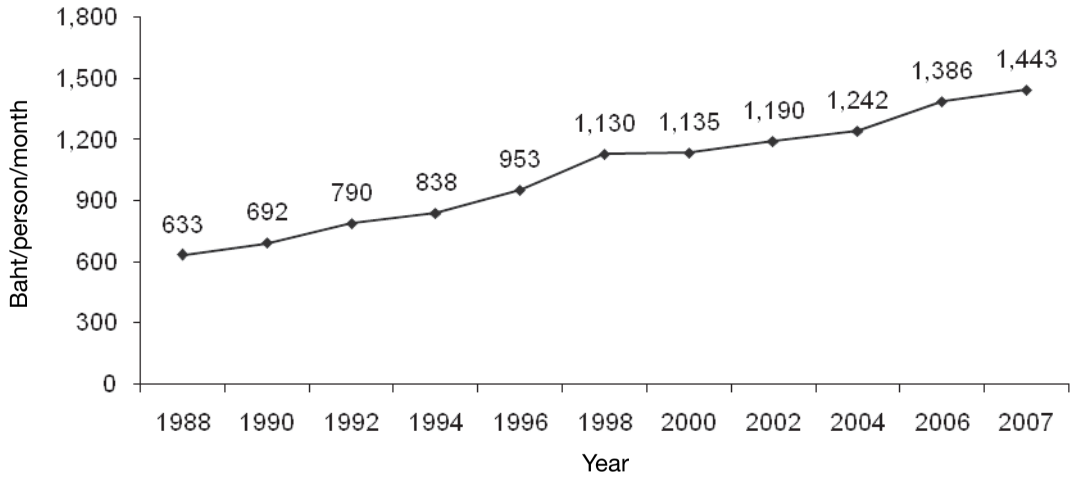
To further investigate the extent of poverty incidence in Thailand, the Office of the National Economic and Social Development Board applies a new technique to determine the poverty line for each household corresponding to its age and sex composition as well as its location. In doing so, households

FIGURE 12.7
Average Monthly Income Per Capita, Nominal and Real Terms (in baht), 1990–2000



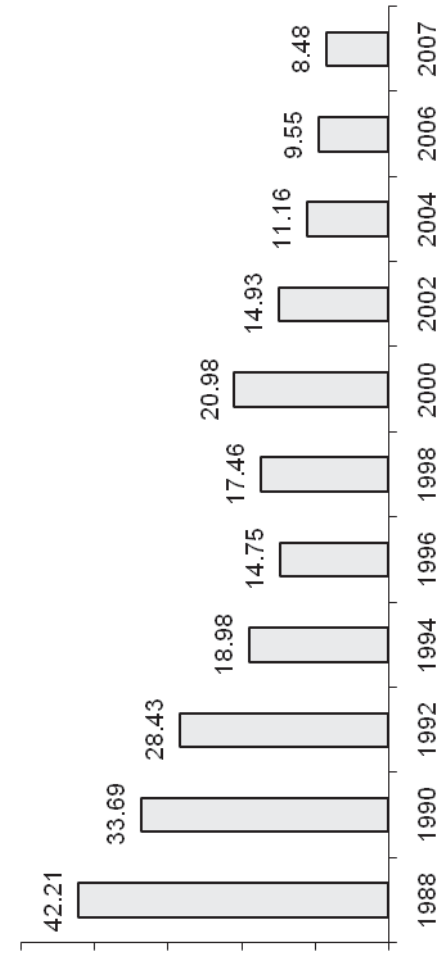
Source: Sarntisart (2005).

FIGURE 12.8
Average Poverty Line for the Whole Kingdom, 1988–2007



Source: Office of the National Economic and Social Development Board (2008).

FIGURE 12.9
Poverty Incidence Measured by the Head Count Ratio, 1988–2007



Source: Office of the National Economic and Social Development Board (2008).

with consumption levels equal to the poverty line will have the same utility level regardless of where they live (Kakwani 1999).

In general, more than half of the poor in Thailand lived in the Northeast and almost all of them lived in rural areas both before and after the crisis, because of both the large percentage of the number of the poor and the large number of total population. Examination of the incidence of poverty at the regional level revealed that, prior to the crisis, the situation of the poor was steadily improving in all regions. But after the onset of the crisis, poverty incidence in almost every region of the country increased, especially in the Northeast, the poorest region of Thailand, where the percentage of the population living in poverty rapidly shot up from 24.54 per cent in 1996 to 30.67 per cent in 1998 and reached 35.34 per cent in 2000 (Table 12.9). Only in the Northern region was there evidence that poverty had slightly declined from 1996 to 1998, although eventually increasing in 2000. During 2002–04, more than half a decade after the crisis, poverty incidence in every region ultimately returned to its pre-crisis level and was reduced further in the consecutive periods.

Table 12.10 depicts the uneven impact of the economic crisis in different areas. Even though both urban and rural areas experienced increases in poverty during 1996–2000, it was more severe in rural areas. Whereas the percentage of the poor in urban areas climbed slightly from 6.84 to 8.63 per cent, rural poverty markedly increased from 18.19 per cent in 1996 to 26.49 per cent in 2000. Despite this finding, as Kittiprapas and Intaravitak (2000) pointed out, the distribution of income in Thailand had been improved as a result of the crisis since upper-income groups lost greater income shares than did lower-income groups.

The incidence of poverty among different age groups also suggests important results. Children aged below 15, especially in rural areas, were most acutely affected by the crisis. The poverty head count measure for children presented the highest increase in poverty incidence from 1996 to 2000, followed by the population aged 60 years and over (Table 12.11).

CONCLUSION

The financial crisis that started in mid-1997 affected individuals and households in Thailand extensively. However, the adverse effects of the crisis were felt unevenly across socio-economic and demographic groups. This study attempts to quantify the impacts of the financial crisis on employment, migration, and poverty in Thailand. It also identifies those vulnerable and disadvantaged groups who most urgently need help.

TABLE 12.9
Percentage and Number of Poor by Region, 1994–2007
(Unit: thousand)

Region	*1994*		*1996*		*1998*		*2000*		*2002*		*2004*		*2006*		*2007*	
	(%)	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*
Bangkok	4.11	247.4	1.21	73.5	1.23	75.8	1.71	106.9	2.24	144.5	0.78	51.3	0.51	28.7	1.14	64.4
Central	11.15	1,419.3	6.13	799.9	7.80	1,045.7	9.03	1,246.7	7.63	1,090.4	4.47	666.2	3.31	525.1	3.08	496.2
North	20.75	2,247.0	17.83	1,951.5	16.47	1,824.9	23.10	2,590.1	20.29	2,290.0	15.68	1,842.1	12.00	1,410.2	12.93	1,518.1
Northeast	28.07	5,513.2	24.54	4,888.9	30.67	6,210.3	35.34	7,281.6	23.06	4,826.9	18.58	3,953.7	16.77	3,620.4	13.05	2,830.3
South	17.82	1,311.2	10.31	778.6	13.98	1,086.3	16.64	1,330.1	9.56	783.5	6.03	505.4	5.49	472.2	5.88	512.8
Whole Kingdom	**18.98**	**10,738.2**	**14.75**	**8,492.4**	**17.46**	**10,243.0**	**20.98**	**12,555.4**	**14.93**	**9,135.4**	**11.16**	**7,018.6**	**9.55**	**6,056.7**	**8.48**	**5,421.7**

Source: Office of the National Economic and Social Development Board (2008).

TABLE 12.10
Percentage and Number of Poor by Area, 1994–2007
(Unit: thousand)

Area	*1994*		*1996*		*1998*		*2000*		*2002*		*2004*		*2006*		*2007*	
	(%)	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*
Urban	9.88	1,675.9	6.84	1,189.7	7.14	1,280.4	8.63	1,594.9	6.43	1,257.3	4.64	932.8	3.62	677.9	3.35	635.9
Rural	22.87	9,062.3	18.19	7,302.7	21.99	8,962.6	26.49	10,960.5	18.93	7,878.1	14.22	6,085.8	12.04	5,378.7	10.65	4,785.8
Whole Kingdom	**18.98**	**10,738.2**	**14.75**	**8,492.4**	**17.46**	**10,243.0**	**20.98**	**12,555.4**	**14.93**	**9,135.4**	**11.16**	**7,018.6**	**9.55**	**6,056.7**	**8.48**	**5,421.7**

Source: Office of the National Economic and Social Development Board (2008).

TABLE 12.11
Percentage and Number of Poor by Age and Area, 1996–2007
(Unit: thousand)

Age	*1996*		*1998*		*2000*		*2002*		*2004*		*2006*		*2007*	
	(%)	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*	*(%)*	*Number*
Urban														
< 15 years old	8.96	354.4	9.99	399.5	12.06	468.9	9.21	378.6	6.56	264.7	5.09	190.3	5.00	179.9
15–59 years old	5.51	653.9	5.70	693.8	7.02	890.3	5.15	686.7	3.56	491.8	2.64	337.0	2.34	305.0
≥ 60 years old	11.48	181.4	10.68	187.1	12.32	235.8	9.06	192.1	7.76	176.2	6.76	150.6	6.36	151.0
Total	**6.84**	**1,189.6**	**7.14**	**1,280.4**	**8.63**	**1,595.1**	**6.43**	**1,257.3**	**4.64**	**932.8**	**3.62**	**677.9**	**3.35**	**635.9**
Rural														
< 15 years old	22.33	2,585.4	26.18	2,969.4	31.92	3,655.1	22.75	2,592.1	17.28	1,970.8	14.72	1,712.1	12.70	1,458.4
15–59 years old	15.73	3,786.4	19.82	4,889.9	23.55	5,820.3	16.29	4,091.5	12.17	3,109.3	9.66	2,590.5	8.53	2,285.2
≥ 60 years old	20.73	934.4	23.30	1,103.9	28.50	1,485.2	23.38	1,194.4	17.23	1,005.7	17.29	1,076.1	15.63	1,042.2
Total	**18.19**	**7,306.1**	**21.99**	**8,963.1**	**26.49**	**10,960.5**	**18.93**	**7,878.1**	**14.22**	**6,085.8**	**12.04**	**5,378.7**	**10.65**	**4,785.8**
Whole Kingom														
< 15 years old	18.93	2,939.7	21.96	3,368.9	26.89	4,124.0	19.16	2,970.7	14.48	2,235.5	12.38	1,902.4	10.86	1,638.3
15–59 years old	12.35	4,440.2	15.15	5,583.7	17.95	6,710.6	12.43	4,778.2	9.15	3,601.2	7.39	2,927.6	6.51	2,590.2
≥ 60 years old	18.33	1,115.8	19.89	1,291.0	24.15	1,721.0	19.18	1,386.5	14.58	1,181.9	14.51	1,226.7	13.19	1,193.3
Total	**14.76**	**8,495.7**	**17.46**	**10,243.5**	**20.98**	**12,555.6**	**14.93**	**9,135.4**	**11.16**	**7,018.6**	**9.55**	**6,056.7**	**8.48**	**5,421.7**

Source: Office of the National Economic and Social Development Board (2008).

Some important findings can be highlighted as follows. First, the economic turmoil produced unpleasant labour market conditions, including substantial layoffs of workers, rapid rises in unemployment and underemployment, and a decrease in labour force participation. As a result, a large number of formerly employed workers in the non-agricultural sectors who previously resided in Bangkok and urban areas decided to return to their families in rural areas, which caused a significant return migration trend. In this regard, agriculture — a sector that had long been neglected — had to absorb such return migrants and their families. The origin communities had to serve as a traditional safety net for the society.

Second, the crisis and its consequences on the labour market not only hindered the trend of rapid poverty reduction in Thailand, it also raised overall poverty. However, the impact of the crisis was uneven. Even though the economic meltdown started in Bangkok, the increase in poverty was much greater in rural areas, particularly the Northeast, which may be a result of substantial rises in unemployment and underemployment in Bangkok and other urban areas and a reduction in remittances that followed. It should be noted that while deterioration in labour market indicators was most prominent in 1998, it was not until 2000 that the worsening poverty situation in Thailand was fully realized.

Finally, among all income groups, the poor were vulnerable to unexpected shocks and needed help the most since they were rarely protected by any security system and rarely accessed any social services or welfare provided by the government.

Learning from the previous crisis, the Thai Government has made numerous efforts to address the current economic downturn and navigate the Thai economy out of the global crisis. Stimulus packages have been immediately launched, together with an attempt to restore the country's accountability and credibility in the national and international arenas, all of which have been implemented based on His Majesty the King Bhumibol Adulyadej's philosophy of a "Sufficiency Economy", which encourages a balanced and moderate development strategy, thus helping the country to develop at the same time as shielding it against any internal and external shocks in the era of globalization.

The first stimulus package consists of eighteen projects that are worth more than 280 billion baht, which are intended to lessen the adverse impact of the crisis and stimulate consumption and investment of private and public sectors in the short term. One of the earlier attempts to immediately boost domestic consumption was the handing out of a 2,000 baht (about US$60) cheque per person to the low income groups of more than nine million

persons countrywide. In order to reduce unemployment and promote self-employment in the local area, the "Training for Unemployed Project" has been specially introduced. Unemployed, potentially unemployed, and fresh graduates are being trained so as to build their capacity, enhance vocational skills, and create more job opportunities and incomes accordingly. Moreover, the government also works with the Ministry of Education to provide a new curriculum for modern agriculture and make available agricultural land for long-term rent at a low cost. In accordance with the "Sufficiency Economy" philosophy, the Thai Government has directly allocated "Sufficiency Economy Funds" to over eighty thousand villages with the aim of encouraging them to develop their own economic efficiency and competitiveness so as to create employment and incomes at the grass-roots level.

Continuing from the first stimulus package is the second package, which aims to create jobs, strengthen competitiveness, and improve essential infrastructure to facilitate the growth of the Thai economy in the long run through the enormous public investment expenditure of 1.56 trillion baht, 1.43 trillion of which is under the "Thai Khem Khaeng Operational Plan 2012". With tremendous effort, the effect of the global crisis on the Thai labour market and overall economy has been mitigated and is relatively small compared to what had been expected based on the 1997–98 financial crisis.

As for international migration, the Thai Government also has policies to help Thais employed overseas by providing short training courses, practical manuals, and labour protection. However, like other major international labour sending countries in Southeast Asia — notably the Philippines and Indonesia — Thailand still has no policy to help return emigrants find jobs or benefit from the skills they have developed while working abroad.

In addition to international migrants, the predicaments of cross-border GMS migrants should also be carefully considered and policies designed to meet their needs. Despite the government's attempts to deport irregular migrants and to reserve job opportunities for Thai workers, demand for cheap and unskilled migrant workers persists. By encouraging employers to invest more in advanced technology, the government can jump start the process of decreasing the demand for unskilled labour and increasing demand for Thai semi-skilled labour.

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13

IMPACT OF GLOBAL RECESSION ON WAGE INEQUALITY IN SINGAPORE

Yothin Jinjarak

The relationship between globalization and poverty has long been the quest in both the academic and policy arena. As the problems of malnutrition and poverty continue to exist in many parts of the developing world, the inequality aspect of income distribution has recently become a focus in industrial countries. Frequently, inequality is associated with the by-product of globalization of consumption and production. Although the causality between inequality and economic performance remains largely unresolved, some anecdotal evidence suggest that inequality has risen steadily during the past few decades concurrently with the breathtaking pace in the process of international trade and financial integration. A number of explanations have been offered in previous studies, including consumption exposure to foreign products, import competition-driven employment allocation, and skill-biased technological progress.[1]

For a small economy, openness to trade means the effects of domestic inflation are inevitably linked to terms of trade fluctuation, which in turn influences foreign competition in both product and labour markets.[2] By and large, a significant strand of the literature examining the impact of inflation on poverty and inequality has documented a number of convincing theories and evidence on the welfare consequences of their relationship. According to an international poll in thirty-eight countries, inflation is the top concern of

the poor, the uneducated, the unskilled worker, and high inflation rates tend to lower the share of the bottom quintile and the real minimum wage, thereby increasing poverty (Easterly and Fischer 2001). The cross-country correlation between inflation and income inequality has subsequently been rationalized, for example, in a political-economy model whereby the positive association is the distributional outcome of government policies (Albanesi 2007). While most of the previous studies are suggestive, so far the model and international evidence only aim at explaining an "average" country, grouping together countries of different size.

This chapter delves further into the relationship between terms of trade, international competition, and real wage inequality for a small open economy, thereby filling an important gap in the literature abundant with large country evidence, particularly the United States. While there is a garden variety of explanation for the role of globalization on inequality, I focus on the recent ones and offer some new evidence on their applicability in a context of Singapore. First, I examine the evolution of real wage inequality, taking into account differences in the consumption baskets between the low- and high-income households. Existing studies using the U.S. data have found that the conventional inequality measure significantly overstated a measure that allows for different expenditure shares across household income and education levels. In the case of the United States, low-income consumers benefit from globalization through cheaper products imported from China, mainly on certain items such as clothing and accessories (Broda and Weinstein 2008).[3] For a small economy such as Singapore, I show that as the expenditure share of low-income households is geared more towards food imports and consumption, the terms of trade fluctuation requires the conventional measure of inequality be adjusted to better capture the globalization effects.

Second, I examine the skilled/unskilled wage premium in relation to two globalization factors: trade deficits/GDP and percentage of immigrants in the labour force. Among the candidates explaining the skill (college-graduate, education) premium in the literature, the effects and interaction of these two factors seem the most uncertain. For instance, while some previous research point to a positive relationship between the skill premium in labour market and import competition in the durable goods sector, the existing evidence fall short on explaining the role of immigrant workers in both the durables and non-durables sectors. For Singapore, one would expect that the empirical implications could be drawn sharply as the skill-premium explanations in the literature are de facto under the assumption of small open economy. Subject to data availability, I show that while the percentage immigrant workers, durables, and nondurables trade deficits are important in understanding the

dynamics of skill premium, the estimated causalities among these variables are empirically inconclusive.[4]

SOME STYLIZED FACTS AND THEORETICAL CONSIDERATIONS

Table 13.1 provides key inputs on trade and wage inequality, comparing between the United States and Singapore during 1988 to 2008.[5] Over these twenty years, Singapore is the most open nation in the world economy, while the United States is always among the bottom five in terms of trade openness. On average, total trade flows amount to 412 per cent of GDP for Singapore (75 per cent growth from 1988–2008), whereas it is only 25 per cent for the United States (11 per cent growth). At the same time, the average of income ratio of the highest to the lowest quintile of households is 13 in both countries. What is striking is that from 1988 to 2008 this ratio has grown by a factor of 10 in Singapore, comparing to an increase of 2 in the United States.

Inequality as measured by relative income above is one of the two ways for measuring the income distribution. The other is absolute deprivation, which measures a minimally acceptable (subsistent) income level, or the poverty line. Both approaches are subject to measurement issues, including changing consumption bundles, difference in costs of living across localities, and incomplete income definition. I focus on the relative wage measure since (1) inequality has recently gained much attention in high-income countries, and (2) as a practical reason, the calculation is straightforward with official statistics publicly available.

TABLE 13.1
Trade and Wage Inequality in 2008 and 1988

	Trade		*Wage Inequality*	
	% of Gross Domestic Product		*Highest/Lowest Quintile Households*	
	Average	*Increase*	*Average*	*Increase*
Singapore	412	75	13	10
United States	25	11	13	2

Source: Department of Statistics (2000); calculated by the author.

To understand the effect of trade on real and relative wage inequality in a small open economy, I first examine the evolution of terms of trade and employment allocation in Singapore. We can see in the first column of Table 13.2 that, as a result of overall export price reduction, terms of trade have deteriorated by roughly 34 per cent from 1990 to 2008. In line with other industrialized countries, the service sector in Singapore has become larger during this period: measuring in terms of the number of workers employed, the service sector has expanded by 63 per cent, whereas the manufacturing sector has shrunk by 6 per cent.

To motivate the empirical exercises in the following section, I illustrate in a stylized model that the real wages of workers depend on their consumption basket. Suppose there are two sectors: manufacturing goods (capital intensive) and services (labour intensive).[6] Let the production function $Y_i = f(L_i, K_i)$, where L denotes labour and K capital, i = [manufacturing (m), services (s)]. Consider the case of specific factors where the earnings of factors of production depend on which sector employs them. In the short to medium run, the capital stock K_i is fixed in each sector, so that only workers (owner of labour) can move between the two sectors. Hence, returns to capitalists (owner of capital) in the manufacturing sector differ from returns to capitalists in the service sector, while the workers earn the same wage in both sectors. If trades result in more expensive services relative to manufacturing, in the long run the capitalists will suffer but the workers will gain in nominal terms (in real terms, the effect depends on the consumption baskets of capitalists and that of workers). However, in the short to medium run the capitalists in the service sector may gain (i.e., its specificity magnifies the effect of price change). On the other hand, for workers in both sectors, the effect of this term of trade adjustment (price of services increase relative to price of manufacturing) on the real wage is ambiguous (i.e., depending on the price of a selected consumption basket used to convert nominal wage to real wage).

The full-employment condition is $L_m + L_s \leq L$. The production function for the economy is

$$Y\left(p_m, p_s, L, K_m, K_s\right) = \max_{L_i \geq 0} \sum_i p_i f_i\left(L_i, K_i\right)$$

The first-order condition is then

$$w = p_m f_{mL}\left(L_m, K_m\right) = p_s f_{sL}\left(L_s, K_s\right)$$

Note that the output from the manufacturing sector is tradable, whereas the service sector is non-tradable. Thus, even with free trade in manufacturing,

TABLE 13.2
Terms of Trade, Employment, and Wages

	Terms of Trade				*Employment (1,000)*			*Wage (SG$)*		
	1990	*2008*	*Change*		*1990*	*2008*	*Change*	*1990*	*2008*	*2008/1990*
Import Prices	101	101	0%	Manufacturing	333	312	–6%	1,395	3,954	2.8
Export Prices	147	98	–34%	Services	881	1,435	63%	1,599	4,069	2.5

Source: Department of Statistics (2000); calculated by the author.

there need not be factor price equalization in this setting. To simplify, we can take the manufacturing as the numeraire, set its price to unity $p_m = 1$, and focus on a change in relative price of services to manufacturing goods, p_s/p_m. Figure 13.1 shows the resultant wage and employment allocation.

Suppose that there is an exogenous increase in the price of services and an exogenous decrease in the price of manufacturing goods. The marginal value product curve of the service sector will shift up by $\Delta\, p_s/f_{sL}$ and the manufacturing sector will shift down by $\Delta\, p_m/f_{mL}$. The size of this term of trade adjustment determines whether wages would increase or decrease, but more workers will be reallocated to the service sector. We can compute the change in the wage as

$$\frac{dw}{dp_s} = f_{sL} + p_s f_{sLL} \frac{dL_s}{dp_s} < f_{sL} = \frac{w}{p_s}$$

$$\frac{dw}{dp_m} = f_{mL} + p_m f_{mLL} \frac{dL_m}{dp_m} > f_{mL} = \frac{w}{p_m}$$

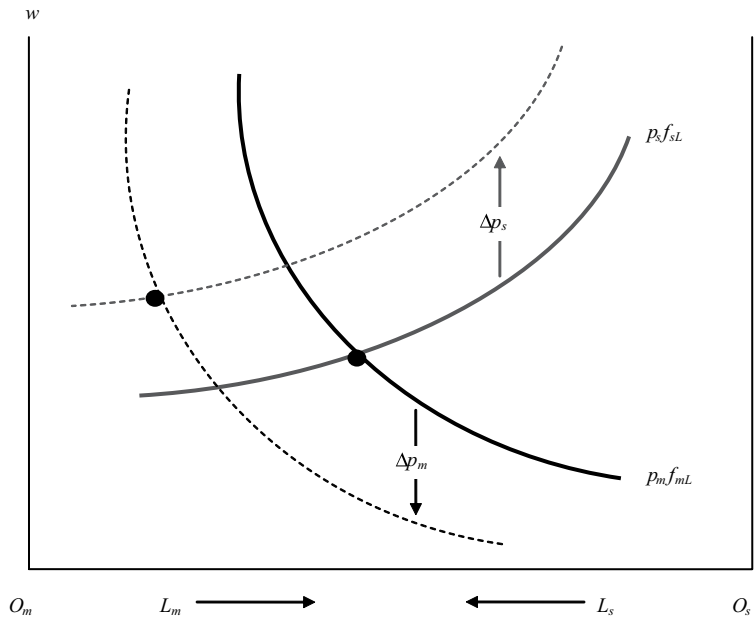
where $dp_s > 0$ and $dp_m < 0$. The first equality follows from $f_{sL} < 0$ and $dL_s/dp_s > 0$; the second from $f_{mL} < 0$ and $dL_m/dp_m < 0$. Following the empirical case of Singapore, suppose that $dp_s > |dp_m|$, then

$$\left[\frac{dp_m}{p_m} = p_m\right] < \left[\frac{dw}{w} = w\right] < \left[\frac{dp_s}{p_s} = p_s\right]$$

The real wage of workers increases in terms of p_m, but falls in terms of p_s. The overall effect on the real wage therefore depends on workers' consumption basket of manufactured goods and services. It also follows that the rental rate of capital which is sector specific falls more than the change of p_m in the manufacturing sector, while it increases more than the change of p_s in the service sector. Note that this characterization is simple enough to explain the factor price adjustment in Singapore, where the total factor productivity growth drove up the real wage, while the average rental rate of capital remained roughly constant (Hsieh 2002).

What is the implication for income redistribution? On real wage, an increase in the relative price of services to manufacturing goods is an inflation tax on the workers, who tend to be poorer and have a smaller proportion of services in their consumption basket, in comparison to the capitalists. To see this in the public finance terminology, let *MU* be the marginal utility of service consumption and *MR* the marginal revenue from inflation tax due

FIGURE 13.1
Wage, Allocation of Workers, and Change in Relative Price — Manufacturing and Service Sector

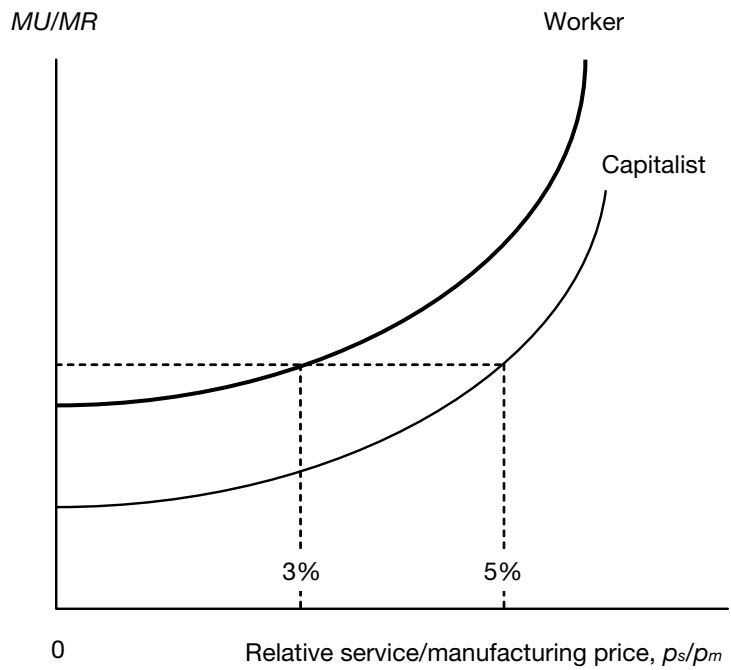


Source: Drawn by the author.

a rise in the relative price of services/manufacturing goods. It follows that $MU_{worker} > MU_{capitalist}$ since the capitalist already has a high level of service consumption, and $MR_{worker} < MR_{capitalist}$ since a 1 per cent increase in relative price of services/manufacturing goods raises the inflation tax revenue on service consumption off a higher base from the capitalist's basket. It follows that (1) *MU/MR* is higher for the worker than the capitalist; and (2) as the relative price of services/manufacturing increases, *MU/MR* therefore rises.

Applying the inflation tax consideration implies that the relative service/manufacturing price should optimally be higher for the capitalist, which is illustrated in Figure 13.2. In the diagram, *MU/MR* increases as the relative service/manufacturing price increases at an accelerating rate, due to the diminishing marginal utility in the numerator, and the lower service consumption in the denominator. If the inflation tax to worker and capitalist is the same at 2 per cent, then *MU/MR* for the worker is above *MU/MR* for the capitalist. As we raise the inflation tax on the capitalist, $MU_{capitalist}$ rises and

FIGURE 13.2
Applying Optimal Inflation Tax



Source: Drawn by the author.

$MR_{capitalist}$ falls. At the inflation tax of 5 per cent, *MU/MR* of both the worker and the capitalist are the same. The 5 per cent is fictitious, but it serves to illustrate the point: for the purpose of income redistribution, inflation on the consumption basket of low-income households (worker, with a smaller proportion of services in the total expenditure) should be lower than that of the high-income households (capitalist).

TERMS OF TRADE AND REAL WAGE INEQUALITY IN SINGAPORE

Consumption of Basket of Goods by Level of Household Income

Imports of goods and services account for 35 per cent of private consumption expenditure in Singapore.[7] While my theoretical consideration in the previous section describes manufacturing versus services, the official statistics do not quantify consumer price inflation into that dichotomy. Instead, the consumer

price indices in Singapore are collected based on seven major categories: food, clothing, housing, transportation, education, health, and recreation. Naturally, the starting point is to make use of the fact that low-income households tend to spend a higher proportion of their income on food necessities.

The distribution of households by income is provided in Figure 13.3. According to the Department of Statistics Singapore (2003), the cutoffs for the lowest 20th and highest 20th quintile of monthly income distribution in 2003 are approximately $795 and $12,792, respectively.

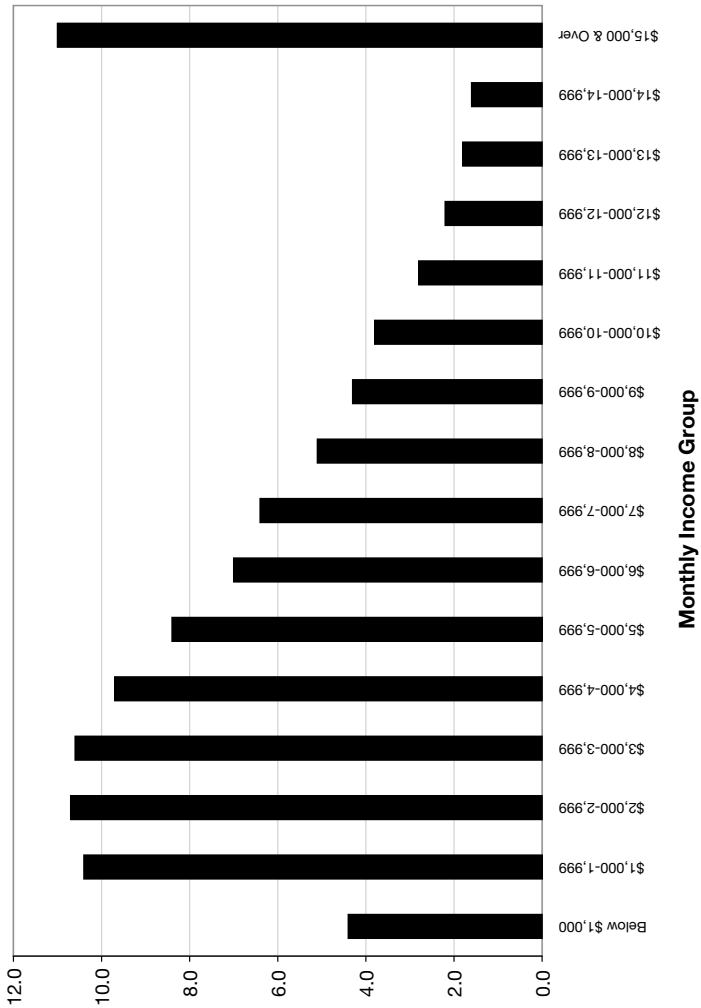
Figure 13.4 provides the official price level by household income level. I rebase the indices so that the value in year 1993 equals to 1. The basket of consumer price indices covers 5,170 brands and varieties of products. The item weights for each household group are drawn from the household expenditure survey during year 2002/03. It is evident that during this fifteen-year period the price level has been rising faster for the lowest 20th household, followed by the 2nd–4th quintile, and the highest 20th group. Because the price series by household income group are constructed by multiplying the aggregate price series to the (constant) expenditure shares of each group, the series do not allow for more detailed investigation on time-varying expenditure shares (i.e., income versus substitution effects), and the effects of quality improvement on products shopped by the households in each income group.

Figure 13.5 shows the ratios of imported food prices to all items' import prices, as well as the ratio of food price to consumer price for domestic consumption in Singapore from 1978 to 2008. We can see that the former ratio is much more volatile in the past thirty years; its coefficient of variation over the period is about 2.5 times larger than the latter.[8] The volatility of imported food price relative to other items is important for understanding inequality, as the food consumption has a larger weight in the basket of the low-income households. The relatively stable ratio for the price series for domestic consumption suggests that the consumer prices on food and other items, particularly services may endogenously respond to the import prices, perhaps due to changing patterns of consumption, or government subsidy on some consumer items.

Because the inflation rate for the lowest 20th households is higher than that for the highest 20th households, I next examine how much of this difference can be attributed to the prices of imports into Singapore. Note that in the following I do not intend to capture general equilibrium interaction. Although it is ideal to use import price for each income group, such data is not available. The estimating price (p) equation is

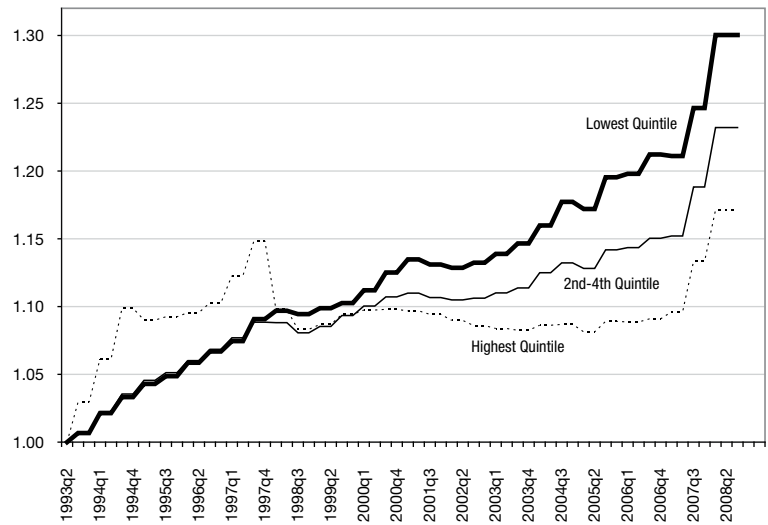
$$p_{j,t} = \alpha_j^l + \beta p_{t-1}^l + \varepsilon_{j,t}^l$$

FIGURE 13.3
Percentage of Households by Monthly Income Group in 2003



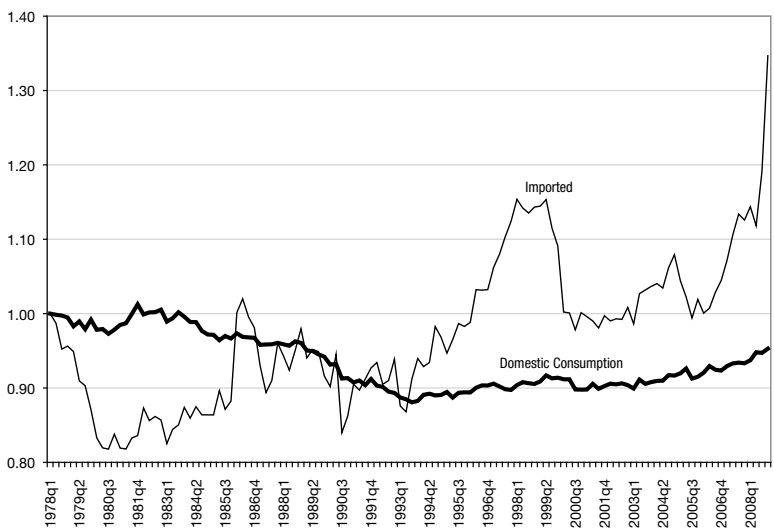
Source: Department of Statistics (2000); calculated by the author.

FIGURE 13.4
Price Level by Income Group



Source: Department of Statistics (2000); calculated by the author.

FIGURE 13.5
Food and All Items Inflation Differentials



Source: Department of Statistics (2000); calculated by the author.

where j denotes household group by income level; l for imported goods, including food and all items; t for time period in quarters. The estimated pass-through β's are in Table 13.3, where the explanatory variables are the lagged import price series for all items in columns 1–3, and lagged import prices of food in column 4–6. For all variables in the estimation, Dickey-Fuller tests cannot reject the null of unit root at the 10 per cent level. Therefore, the regression estimates are potentially spurious, unless these variables are co-integrated. I find that the residuals from the ordinary least squares (OLS) are stationary in the case of lagged import prices of food as the explanatory variable. The results therefore suggest a co-integrating relationship between consumer price levels by income group and the imported food prices. On the size of coefficient estimates, columns 1–3 show that the effects of lagged import price for all items on the consumer prices by income group are small and significant only in the case of the lowest 20th group price households. On the other hand, the coefficient estimates using lagged imported food prices are all statistically significant at the 1 per cent level. The estimated $\beta = 0.274$ implies that a 1 per cent increase in the imported food prices is associated with, or "pass-through", a 0.274 per cent increase in the price level of the lowest 20th income group. Column 6 shows a stronger effect of the imported food prices on the highest 20th income group, suggesting a non-linearity in the pass-through of imported food price to consumption price indices across household income levels (as well as potential interactions between imported food prices and other products' prices; else the pass-through rates would have been higher for lower-income households). Overall, the imported food prices explain about 98 per cent of variation in the consumer price level for the low-income household group, and about 48 per cent for the high-income household group.

The estimated pass-throughs above have important implications on real wage inequality: imported food prices influence consumer price levels, and the low-income households tend to spend a higher proportion of their income on food necessities. Let us examine the wedge between conventional inequality measures and the measures of inequality adjusted for the differences in consumption baskets of the lowest 20th and highest 20th income groups. The wedge can be expressed as:

$$\Delta\left[\frac{w_{80th} / p_{80th}}{w_{20th} / p_{20th}}\right] - \Delta\left[\frac{w_{80th} / p}{w_{20th} / p}\right]$$

Because inflation among the lowest 20th quintile is higher than that of the highest 20th quintile, the conventional measurement of income

TABLE 13.3
Impact of Changes in Import Prices on Price Level of Consumption Baskets, 1993–2008
OLS estimates with standard errors in parentheses

	Price Level of Consumption Basket by Income Quintiles					
	Lowest	*2nd–4th*	*Highest*	*Lowest*	*2nd–4th*	*Highest*
Lagged Import Prices: All Items	0.108 (0.047)**	0.019 (0.047)	–0.054 (0.073)			
Lagged Import Prices: Food				0.274 (0.025)***	0.249 (0.026)***	0.307 (0.051)***
R-sq.	0.947	0.894	0.179	0.982	0.959	0.485
Quarters	62	62	62	62	62	62
Dickey-Fuller test statistic on the residuals: p-value	0.4619	0.6852	0.1660	0.0002	0.0042	0.0012

Note: *** (**, *) signifies statistically significant at 1 (5, 10) per cent level.
Source: Department of Statistics (2000); calculated by the author.

inequality is understated. Table 13.4 provides a summary of disaggregate inflation from 1993 to 2008. We can see that while the inflation rates of services (education, health, recreation) have been high in Singapore, the same applies to food inflation. Recently, the inflation on food items (19.1 per cent) is second only to the cost of health services (22.8 per cent). In the context of income redistribution, this means the nominal wages of the low-income households are subject to a smaller inflation tax than the high-income households. However, as we will see shortly, this does not mean that the real wage inequality is falling.

Using the above equation, indicating inflation rates and the expenditure shares by household income group, I calculate inflation differentials by income group in the bottom panel of Table 13.5. The key differences between the low- and high-income households are their expenditure shares on food and recreation services. Column 1 of Table 13.6 provides the conventional measure of inequality. Column 2 then reports the adjustment on the conventional measure allowing for different consumption baskets of the lowest 20th and highest 20th income groups. I find that the lowest 20th inflation rate over the 1993–2008 period is higher than that of the highest 20th: real income inequality has increased by 23 per cent more than implied by the conventional measure (100*2.00/8.65). The wedge between the conventional and new measure is due to the latter allowing for differences in the expenditure shares across household income groups. In particular, in the consumption basket of the lowest 20th households, food accounts for 30 per cent, whereas it does only for 17 per cent in the consumption of the highest 20th. Further, while the expenditure share on recreation service for the highest 20th is larger than that of the lowest 20th (20 per cent in the former and 13 per cent in the latter), its inflation rate has been 6 percentage points smaller than the food inflation. Since food is consumed disproportionately from the total budget for the low-income households, and services for the high-income households, this means the conventional measure using aggregate inflation understates the real wage inequality (the two measures are additive).

Column 3 of Table 13.6 provides the adjustment of inequality measure allowing for different consumption baskets that are attributable to the fluctuation in imported food prices. Using the estimates in columns 1 and 2 of Table 13.6, I find that from 1993 to 2008 the imported food inflation amounts to 43 per cent of the upward inequality adjustment.[9] We can also see that the share of inequality rise amplified by the imported food prices has become larger in the recent periods, accounting for 58 per cent from 1998 to 2008 and 70 per cent from 2003 to 2008.

TABLE 13.4
Disaggregate Inflation

	All Items	*Food*	*Clothing*	*Housing*	*Transport*	*Education*	*Health*	*Recreation*
Price Index								
1993	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
1998	1.082	1.110	1.023	1.063	1.076	1.156	1.157	1.047
2003	1.103	1.136	0.978	1.062	1.057	1.249	1.284	1.105
2008	1.239	1.328	1.008	1.203	1.109	1.431	1.513	1.257
Inflation (%)								
2008–1993	23.9	32.8	0.8	20.3	10.9	43.1	51.3	25.7
2008–1998	15.7	21.7	–1.5	13.9	3.3	27.6	35.5	20.9
2008–2003	13.6	19.1	3.0	14.1	5.2	18.3	22.8	15.2

Source: Department of Statistics (2000); calculated by the author.

TABLE 13.5
Expenditure Shares in 2003 and Group-specific Inflation

A: Reported Expenditure shares

	All Households	*Lowest*	*2nd–4th*	*Highest*
	Expenditure Shares			
Food	0.23	0.30	0.24	0.17
Clothing	0.04	0.03	0.04	0.04
Housing	0.21	0.26	0.20	0.22
Transport	0.22	0.15	0.21	0.23
Education	0.08	0.07	0.08	0.09
Health	0.05	0.07	0.05	0.05
Recreation	0.17	0.13	0.17	0.20

B: Estimated Group-specific Inflation

	All Households	*Lowest*	*2nd–4th*	*Highest*
	Inflation (%)			
2008–1993	23.9	30.0	23.2	17.1
2008–1998	15.7	20.3	14.4	7.3
2008–2003	13.6	16.1	12.2	8.8

Source: Department of Statistics (2000); calculated by the author.

TABLE 13.6
Impact of Group-specific Inflation on Inequality

	Change in Conventional Inequality	*Adjustment Due to Group-specific Weights*		*Share of Inequality Rise Amplified by Food Imports*
		Total	*… from Food Imports*	
1993–2008	8.65	2.00	0.86	43%
1998–2008	5.93	2.01	1.16	58%
2003–2008	2.11	1.19	0.83	70%

Source: Department of Statistics (2000); calculated by the author.

Motivated by the analysis in Figures 13.1 and 13.2, we now see empirically that terms of trade deterioration can translate into an inflation tax on the workers and low-income households because of their consumption patterns. The estimation in Table 13.6 indicates the effects of terms of trade via rising

imported prices on the real wage inequality, allowing for expenditure shares across household income levels. However, this estimation ignores the general equilibrium effects of terms of trade on domestic inflation for at least two reasons. First, I show in the previous section that deterioration in the prices of manufacturing exports and a rise of price level in the service sector has general equilibrium effects on employment of workers between the two sectors, and real wage adjustment depending on consumption baskets of the workers. When the real wage increases, the consumption weight on services will become larger (higher income affords more service consumption). Since services have become more expensive, this means that I may understate the effects of terms of trade adjustment on income inequality between the high and low-income households. Second, whether the workers are better off as a result of employment reallocation also depends on the relative wage of the skilled relative to the unskilled. I delve into this issue in the following.

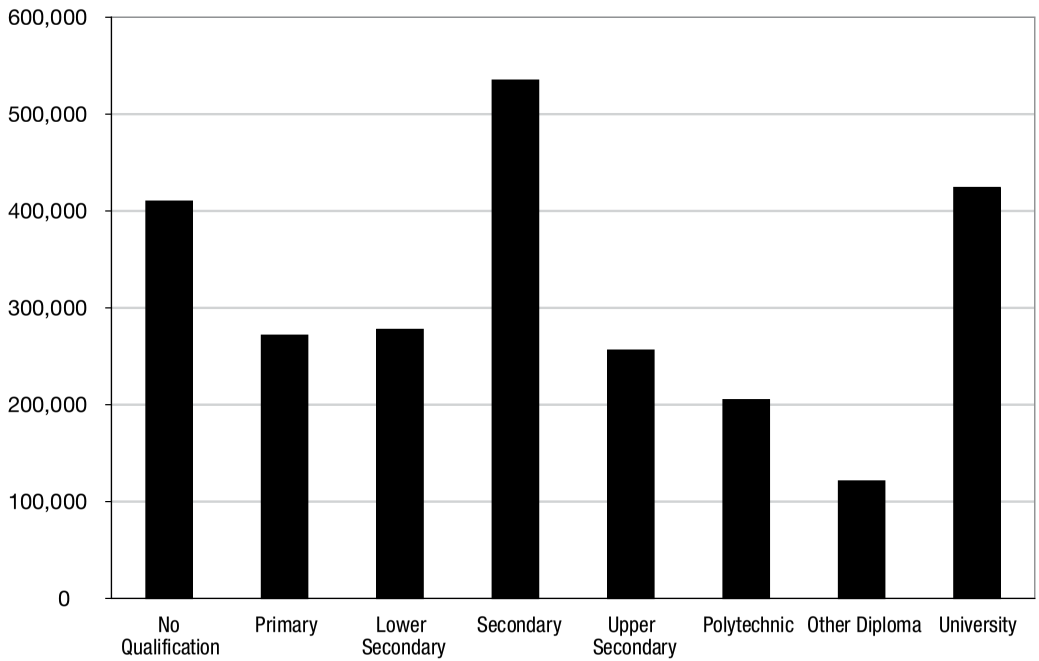
IMPORT COMPETITION AND THE SKILL PREMIUM

Of course, the extent that workers are affected by terms of trade deterioration varies across sectors, which in turn depends on that workers' skill and education. The increase in relative price of services not only shifts employment from the manufacturing to the service sector and raises the overall wages (Figure 13.1), but it could also affect quantities of high-skilled workers and the skill premium (Buera and Kaboski 2009). I first report some preliminary analysis on the skill premium based on the latest survey data between 2005 and 2007. Figure 13.6 provides the distribution of labour force by education level in 2005, showing that the university graduates account for a fifth of the total. The wage variable is defined as the natural logarithm of average monthly earnings (gross starting salary).[10] My focus is on understanding the return to skill as measured by the log wage differential between university graduates, the skilled worker (s), and polytechnic graduates, the unskilled worker (u):

$$w_t = \ln \overline{w_{s,t}} - \ln \overline{w_{u,t}}$$

In the literature the skill (or college) premium is measured as the wage differential between the university graduates and the high-school dropouts (or graduates). Using Singapore data, I am constrained to use the difference between the university graduates (holders of bachelor degrees) and polytechnic graduates (holders of diplomas). We could interpret this measure as a return to skill, as well as a return to education. According to this measure, the skill

FIGURE 13.6
Labour Force by Education Level in 2005



Source: Department of Statistics (2000); calculated by the author.

premium rises from 0.408 in 2005 to 0.463 in 2007, or almost 6 per cent. While this finding is suggestive, a better understanding of the relationship between the skill premium and its potential determinants requires long time-series data. With such data, one can proceed to study the levels of the relevant variables and to test for common stochastic trends, and co-integration between the skill premium and its determinants.

To understand the link between import competition and skill premium, let us first round up some candidate explanatory variables drawn from the literature using the data in recent years.[11] These variables include (1) the number of university graduates relative to polytechnic graduates; (2) the unemployment rate; (3) the percentage of workers not in unions; (4) the percentage of immigrants in the population; (5) the labour-force participation rate of females; (6) research and development expenditures per person in the labour force; (7) net imports of manufacturing goods as a percentage of GDP; and (8) net imports of services as a percentage of GDP. The relative supply of university graduates to polytechnic graduates is calculated from the economically active residents aged fifteen and over compiled by the Ministry of Manpower. The unionization, immigrant labour force, female participation, research and development (R&D) per person ($1,000), and durables and nondurables deficits[12] data are drawn from the *Yearbook of Statistics* (Department of Statistics Singapore 2008).

Between 2005 and 2007, some suggestive findings are shown in Table 13.7. The top panel provides the two-year change of candidate factors and a sign of their expected effect on the skill premium. Except female participation in the labour force, other variables appear to have the expected effects on the skill premium. The zero growth rate of relative university/polytechnic supply does not match with the increase in the skill premium between these two years. However, while the relative supply of university graduates increases on average 7 per cent per year since 1991, the increase has been at a slower rate, which may partly explain a widening skill premium over the short to medium run.[13] A fall in the unemployment rate allows for a higher skill premium (the opposite would mean a tight labour market, which depresses the premium). A larger percentage of workers not in unions means higher exposure of nominal wage to competition for the skilled workers, thereby increasing the skill premium. As one would expect from the skill-biased technological change, R&D per person in the labour force is positively associated with the skill premium.

This leaves us with two globalization-linked candidates: the percentage immigrants in the labour force and durables and nondurables trade deficit. Conceptually, the immigration effect is ambiguous as it depends on the

TABLE 13.7
Skill Premium and Candidate Explanatory Factors

A: Years 2005 and 2007

	2005	*2007*	Δ	*Expected Effect*
University/Polytechnic Premium	40.8	46.3	5.4	
Finance/Hotel and Restaurant Premium	147.6	154.6	7.0	
University/Polytechnic supply	1.9	1.9	0.0	[–]
Unemployment rate	4.2	2.9	–1.3	[–]
Percentage not in unions	81.0	82.0	1.0	[+]
Percentage immigrants	26.3	30.3	4.0	[?]
Female participation	52.0	54.3	2.3	[–]
R&D per person in labour force	1.1	1.3	0.2	[+]
Durables trade deficit	–19.7	–17.0	2.7	[?]
Non-durables trade deficit	–3.1	–3.9	–0.8	[?]

B: Correlation between Skill Premium (Finance versus Hotel/Restaurant) and Candidate Explanatory Factors, 1991–2008

	Wage Premium	*Percentage Immigrants*	*Durables Deficit*
Percentage Immigrants	0.7171		
Durables Deficit	–0.9057	–0.6647	
Non-durables Deficit	–0.9578	–0.5859	0.9509

C: Correlation between Skill Premium (University versus Polytechnic Graduates) and Candidate Explanatory Factors, 1997–2007

	Wage Premium	*Percentage Immigrants*	*Durables Deficit*
Percentage Immigrants	–0.4580		
Durables Deficit	0.9226	–0.5098	
Non-durables Deficit	0.8703	–0.4672	0.9701

Source: Department of Statistics (2000); calculated by the author.

composition of immigrant workers across education levels. Borjas (2009) argues that the short-run wage effect of immigration is negative in a wide array of possible scenarios, and that even the long-run effect of immigration

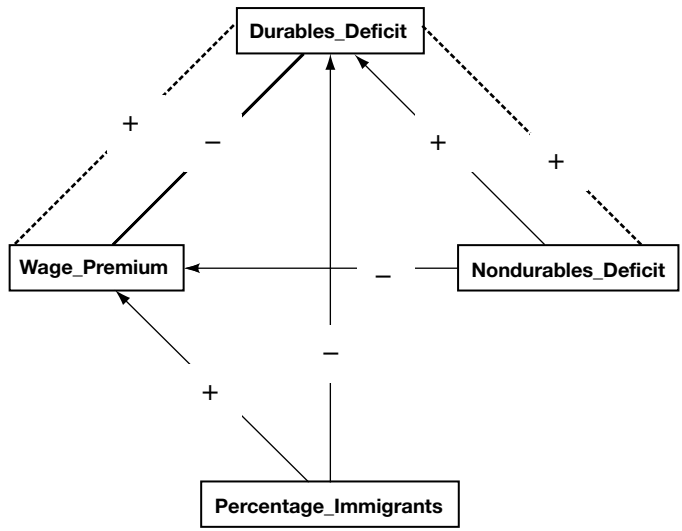
may be negative if the impact of immigration on the potential size of the consumer base is smaller than its impact on the size of the workforce. In addition for Singapore, immigrant labour forces may enlarge skill premiums from the above (attracting highly educated and skilled workers) and from the below (immigrant workers competing in the domestic unskilled labour market), or lower the premium in the opposite cases (i.e., highly educated foreign workers are attracted by high wages in Singapore, thereby increasing competition in the skilled labour market).

On the effect of import competition on relative wages, Borjas and Ramey (1995) show in the case of the United States that trade in durable goods has a strong effect on the college (or skill) premium because many of the durables industries employ a disproportionate share of less-educated workers, are highly concentrated, earn significant rents, and share those rents with their workers through higher than average wages. An increase in the durables trade deficit therefore leads to a decline in relative wages of less educated (unskilled) workers. Applying this logic to Singapore is a challenge, given its roles as intermediaries in entrepôt trade.[14] In general, net of customs, insurance, and freight charges, re-exports of goods tend to be much more expensive when they leave the entrepôt than when they enter. This means that the impact of durables and nondurables trade deficits on the skill premium in Singapore can be quite different from the U.S. findings.

To have a meaningful comparison with the U.S. studies, an empirical test for Singapore requires a time-series of the skill premium for forty years or more, which is simply not available.[15] To overcome the data issues, I focus on the two measures of skill premium: (1) relative wage between finance versus hotel and restaurant sectors; (2) relative wage between university versus polytechnic graduates. The finance versus hotel and restaurant wage premium seems a good proxy given that both are services, and the size of the service sector has been more than twice the size of the manufacturing sector over the past decade.

Table 13.7-B reports correlations between the finance versus hotel and restaurant skill premium, percentage immigrant workers, and durables and nondurables trade deficits, indicating that the variables are all highly correlated. As the series are relatively short (1991–2008), I apply the causal search using graphical causal model (Spirtes et al. 2001). Like in most causality tests, this approach requires that no variable not included in the analysis is a cause of more than one variable included; the test rules out latent variables and correlation among random error terms. The results in Figure 13.7 show that the percentage immigrants in the labour force is positively associated, and the nondurables trade deficit is negatively associated with the skill premium,

FIGURE 13.7
Causality Test on the Possible Determinants of Skill Wage Premiums



Notes: This figure plots the direction of causalities based on the search using graphical causal model. The arrow indicates that the relationship is statistically significant at 5 per cent level. The solid line is the result from using finance/hotel and restaurant wage premium (1991–2008); the dashed line is from university/polytechnic wage premium (1994–2007).
Source: Drawn by the author.

both directly and indirectly through the effect of durables trade deficit. With fifteen observations, I consider these results suggestive. To describe these estimates in further details, denoting in matrix form the data generating process of the skill premium (w), percentage immigrants (I), durables deficit (D), and nondurables deficit (N)

$$\begin{aligned} I &= \varepsilon_I \\ D &= a_{DN}N + \varepsilon_D \\ N &= \varepsilon_N \\ W &= a_{WN}N + a_{WD}D + a_{WN}N + \varepsilon_W \end{aligned} \quad ; \quad Y = \begin{bmatrix} W \\ I \\ D \\ N \end{bmatrix}, E = \begin{bmatrix} \varepsilon_W \\ \varepsilon_I \\ \varepsilon_D \\ \varepsilon_N \end{bmatrix}$$

so that we can express the estimated association between the wage premium (finance/hotel and restaurant) and other covariates.

$$AY = \begin{bmatrix} 1 & .018 & .144 & -.047 \\ 0 & 1 & 0 & 0 \\ 0 & -.527 & 1 & 1.566 \\ 0 & 0 & 0 & 1 \end{bmatrix} \begin{bmatrix} W \\ I \\ D \\ N \end{bmatrix} + \begin{bmatrix} \varepsilon_W \\ \varepsilon_I \\ \varepsilon_D \\ \varepsilon_N \end{bmatrix} = E; \Omega = E\left(EE'\right) = \begin{bmatrix} .07 & 0 & 0 & 0 \\ 0 & 21.30 & 0 & 0 \\ 0 & 0 & 47.14 & 0 \\ 0 & 0 & 0 & 37.48 \end{bmatrix}$$

Next, I examine the university versus polytechnic wage premium. The data are available for 1994–2000 and 2004–07 (nine years); the estimates using finance/hotel and restaurant premium would tend to be more reliable. Panel C of Table 13.7 provides correlations for the variables in this second set of samples. I summarize the results of the causality test in the matrix form below. Overall, using university versus polytechnic premium the coefficient estimates are much smaller than in the previous sample of finance versus hotel and restaurant premium. The percentage of immigrants in the labour force does not affect either the skill premium or durables deficit in this sample. The positive effect of nondurables deficit on durables deficit is still significant (a one percentage point increase of nondurables deficit causes a 0.626 per cent increase in durables deficit), but not its negative effect on the skill premium. The effect of durables deficit on wage premium is now positive and significant (a one percentage point increase of durables deficit causes 1 per cent increase in the skill premium), which is consistent with the U.S. findings. The two exercises performed on different measures of skill premiums are contradictory, which is possibly due to the small sample size (9–15 observations). While the estimation casts doubts on the previous findings, an additional decade or more of data would make possible the robustness checks on these results.

$$AY = \begin{bmatrix} 1 & 0 & .010 & 0 \\ 0 & 1 & 0 & 0 \\ 0 & 0 & 1 & .626 \\ 0 & 0 & 0 & 1 \end{bmatrix} \begin{bmatrix} W \\ I \\ D \\ N \end{bmatrix} + \begin{bmatrix} \varepsilon_W \\ \varepsilon_I \\ \varepsilon_D \\ \varepsilon_N \end{bmatrix} = E; \Omega = E\left(EE'\right) = \begin{bmatrix} .006 & 0 & 0 & 0 \\ 0 & 19.707 & 0 & 0 \\ 0 & 0 & 35.934 & 0 \\ 0 & 0 & 0 & 38.258 \end{bmatrix}$$

CONCLUDING REMARKS

International trade may influence inequality, conditional on historical experiences, cultural factors, and preferences for equality. This chapter examines how openness to international trade affects domestic wage inequality. The empirical findings in small economy Singapore are in contrast to those found in large countries such as the United States. First, globalization and the resulting higher inflation rates among low income households in Singapore

have understated the extent of income inequality as measured by conventional measurement. In the United States, however, globalization has reduced the price from products consumed by the lower income households. Second, the presence of immigrants in Singapore has been positively associated with skilled premium and hence wage inequality. This is in contrast to the finding in the United States, where the presence of immigrants has reduced wage inequality. Third, the existence of non-durable trade deficit in Singapore is negatively related to skill premium. In contrast, in the United States, trade deficit in durable goods increased the skill premium.

This chapter highlights the impact of globalization on wage inequality via three operating channels: through trade and then inflation rate; through immigration and then skilled premium; and through non-durable trade deficit and then skilled premium. Through these channels the global recession may expose wage inequality to external labour-market conditions. If increased foreign competition is stronger in sectors using low-skilled workers and/or immigrants intensively, the sensitivity of those workers' wages to the prevailing unemployment should increase, and hence worsening wage inequality, as the global recession deepens. The evidence in this chapter shows the potential of the three channels mentioned.

Delving further, the immediate impacts of the global recession on wage inequality will depend on inflation and consumption baskets at the household level. The impacts will also depend on how the labour supply varies as the real wages (contracted nominal minus inflation rate) fluctuate. Both the high- and low-income households would tend to reduce expenditure on durables while keeping expenditures on food and necessities constant, more so for the low-income households. Further, the response of household depends critically on real saving and wealth, as well as the role of government, including both fiscal and monetary stimulus carried out during the recession.

For a small open economy, a number of unexplored questions on globalization and inequality are in order. First, terms of trade adjustment and the resultant inflation pass-through may affect the value of nominal assets differently across groups of households (e.g., rich versus poor, old versus young) depending on their nominal wealth positions.[16] The importance of this consideration stems from the fact that globalization has increased the integration not only in trade but also in finance. High-income households usually have better access to international diversification, which implies that the effects of exchange rates, terms of trade, and inflation would have some distributional implication on earning inequality.[17] Second, it would be useful to examine at the firm level the association between firm size and the real wage inequality and skill premium. This evidence will provide

further insights on how import competition drives wage inequality across skill and education levels, controlling for the firm and industry exposure to international trade.[18]

Third, given the similarities between Singapore and Hong Kong in terms of their size, financial centre, and entrepôt trade, future research may test, subject to data availability, whether there is any difference in the relationship between the skill premium and candidate factors for the two small open economies. Finally, I have so far considered wage inequality as an integral part of income and consumption differences across households and workers. Future research may incorporate the role of demographics, taxes, and transfers, and investigate whether the income and consumption measures of inequality move at the same rate and in the same direction, taking into account the international factors facing a small open economy highlighted in this study.[19]

Notes

The author would like to thank Aris Ananta, Manu Bhaskaran, Chew Soon Beng, Aekapol Chongvilaivan, M. Ramesh, Chris Sakellariou, Steve Sheffrin, seminar participants at the Institute of South East Asian Studies and Institute of Policy Studies (LKY School of Public Policy), National University of Singapore for useful comments and suggestions, and Lilian Loke for outstanding research assistance. Financial support from the School of Humanities and Social Sciences of Nanyang Technological University is gratefully acknowledged.

1. See Barro (2000) for economic growth and inequality; Acemoglu (2003) and Rodrik (1997) for globalization and inequality; Alesina and Giuliano (2009) for preferences for inequality across countries; Boyan (2009) for technology and inequality. For a comprehensive survey on wage inequality in the United States, see Katz and Murphy (1992), Autor et al. (2005), Lemieux (2006*a*, 2006*b*, and 2008).
2. As an illustrative example, when the export price falls relative to import price (i.e., food and petroleum), a worker must therefore work more hours at the current wage to maintain the present consumption level.
3. Broda and Romalis (2008) find that (1) rich U.S. households pay more than poor households for identical goods, and (2) trade with China drives down the prices of retail goods paid by poor households by more than it drives down the prices paid by rich households. Moretti (2008) finds that college graduates are increasingly exposed to a high cost of living so that the relative increase in their wage is smaller than the relative increase in their nominal wage.
4. See Borjas and Ramey (1994) for the investigation using the U.S. data.
5. Official data and statistics in this study are extracted from Datastream, unless otherwise indicated. For Singapore, the primary sources are the Department of Statistics and the Ministry of Manpower; for the United States, the Census

Bureau. Openness data are from the Penn Table and World Development Indicators.

6. This is an application of the short-run Heckscher-Ohlin model. See Feenstra (2004) pp. 71–74.
7. Based on the latest year 2000 input-output tables (Department of Statistics Singapore 2000).
8. Dickey-Fuller and Phillips-Perron tests for unit root indicate that both series are non-stationary.
9. For example, from 1993 to 2008, the conventional and adjusted measure of inequality is 2.11 and 3.29, respectively. The ratio of food inflation pass-through into price level of the lowest 20th and the highest 20th is 0.247/0.307 = 0.89. The adjustment due to the imported food inflation is (3.29*0.89) – 2.11 = 0.83.
10. Due to data availability, the wage variable is not adjusted for experience.
11. See Levy and Murnane (1992).
12. For international trade in durables, I use the imports and exports of machinery and equipment (electronics and non-electronics), which account for 54 per cent of total trade flows in 2007.
13. Using sixteen years of observations, $\ln[\textit{Relative Supply}] = 0.069\,\textit{Year} - 0.002\,\textit{Year}^2 + 0.855$, Adj. $R^2 = 0.810$. Motivated by the role of financial centre in labour market, a useful extension, subject to data comparability, would test whether the wage premium – relative supply relationship are significantly different between Singapore and Hong Kong.
14. See Feenstra and Hanson (2004).
15. An alternative would be a wage difference between production and non-production workers in manufacturing industries, though the comparable time series across industries are not available. Ho and Hoon (2003) argue that the relatively stable wage inequality between the skilled (managerial and professional) and unskilled (production and manual) workers in Singapore are driven by international outsourcing.
16. See Doepke and Schneider (2006).
17. While beyond the scope of this paper, this issue could be examined in the general equilibrium context. For studies on real exchange rate, trade, and wage inequality, see for example Aizenman and Frenkel (1988) and Topel (1997). On a related issue, an environment where wages are flexible and negative terms of trade shocks coincide with asset price deflation means the implementation of macroeconomic policies may be a challenging task. In such an environment, say negative real interest rates, an attempt at increasing interest rates to reduce the effects of negative terms of trade would be difficult (McCulley 2008).
18. See Comin et al. (2009) for the U.S. evidence on the relationship between sales and wage volatility at the firm level; Klaus Wälde and Pia Weiß (2007) for the impact of international competition on wage inequality through downsizing of firm size; Gueorgui Kambourov (2009) for occupational mobility and wage inequality.

19. For example, taxes and transfers may endogenously respond to fluctuations in terms and trade and business cycles. Meyer and Sullivan (2009) find sharp differences between income and consumption measures of poverty in the United States.

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14

THE URBAN POOR DURING THE GLOBAL FINANCIAL CRISIS AND ECONOMIC DOWNTURN IN VIETNAM

Dang Nguyen Anh

FROM INFLATION TO RECESSION

The intensified impact of the global financial crisis changed growth projections dramatically. Virtually no country, developing or developed, has escaped the impact of the widening crisis. Growth in developing countries, whose economies had been expected to expand by 6–7 per cent in 2009, has been marked down to 3–4 per cent and many economies of high-income countries entered into recession in 2009. The current difficulties of the global economy have adversely affected the lives of most people, but the urban poor are bearing a larger and heavier part of the impact. Women, children, migrant workers are the most vulnerable, less protected, and face the greatest difficulties in recovering from the crisis, regardless of policy support provided by the government (World Bank 2009).

Although countries that entered the crisis with stronger fundamentals and less integration into the global economy may have been less affected, Vietnam's economy was in a tough time in 2009. This is the largest global recession Vietnam has experienced since its market transition began in 1986. Foreign direct investment has slowed while exports and remittances from

Vietnamese abroad were dramatically falling. It would be very hard for the country to achieve high economic growth. Yet, the economy still grew at a positive and relatively high rate, at 5.34 per cent in 2009, the lowest in seven years. The growth was due mainly to huge amounts of capital and favourable loans provided by the government for state enterprises under the economic crisis. Indeed, this level of growth could not have been achieved without the government's stimulus packages.

In May 2008, the Vietnamese Government was preoccupied with curbing double-digit inflation as oil and commodity prices surged to unprecedented levels not seen in decades. The State Bank had to implement a series of interest rate hikes to rein in inflation. The tight monetary policies were adopted in the rest of 2008, and then Vietnam was fighting a different kind of battle — recession. The financial crisis has already led to a slow down in foreign direct investment, a reduction in export earnings, a reduced number of tourists, and a decline in remittances from migrants abroad. With exports plunging and a sharp drop in investment, which has been the driver of growth, hundreds of thousands of workers lost their jobs. Like other governments across Asia and around the world, the Vietnamese Government was rushing to come up with economic stimulus packages to maintain growth and avoid slipping into deep recession under the effects of the global financial crisis.

Having experienced the inflation storm in 2008, food prices were not going down in Vietnam in 2009. Commodity prices remain high compared with those in 2006. Food price increases have driven prices of non-food items in Vietnam. The recent decision of the government to increase electricity charges has actually kept the prices high. Dairy products have also experienced sharp price hikes. The price of powdered milk, for example, has sharply increased, while the prices of beef and poultry doubled, and have not declined since 2008. The worldwide declines in fuel prices in 2009 do not imply that problems have disappeared. Indeed, the gasoline prices have been set at high levels in Vietnam, even though the worldwide price of crude oil has been falling considerably. Consequently, the poor have been trying to meet the increase in expenditures due to high prices.

As economic recession spreads, what should be the policy responses? Coping with the economic recession, maintaining economic growth, and ensuring social security are the government's top priorities in 2009. Major solutions should target practical assistance for small and medium enterprises and household businesses that create numerous jobs but face more difficulties than other economic sectors. A stimulus package for the finance system has been provided to stimulate both demand and supply side of the market. The government also reduces selected import tariffs and allows selected

companies to delay paying tax for the first nine months of this year. It also refunds this year's value-added tax paid for all materials used to make exports. The reduction of the prime interest rate five times since October 2008 has been designed to help exporters.

The global financial and economic crisis has far reaching consequences and is also expected to shape the growth and development prospects for developing countries, including Vietnam. Since the recession hit Vietnam in late 2008, the focus of the government has been on macro stabilization, on how to boost domestic demand, and on how to deal with the immediate economic and social disruptions created by the crisis. Much less attention has been paid to the medium and longer term influences of the crisis on poverty and more broadly the well-being of the poor.

The main goal of this chapter is to examine the characteristics of the urban poor in Vietnam for a better understanding of the impact of the financial crisis. The present study relates the crisis to the vulnerable poor in Vietnam who have been hit hardest by the global financial crisis and their coping strategies to survive and get out of the crisis.

The remainder of the chapter is structured as follows. The next section provides an overview on the urban poor in Vietnam. Then the chapter focuses on the assessment of the impacts of the economic downturn on the urban poor in terms of unemployment, reduced income, and lowered living standards. The increased vulnerability of children, women, and migrants is analysed and discussed. The end of the chapter offers some concluding remarks and suggests key policy interventions to minimize the impact of the financial crisis.

SOME BASIC CHARACTERISTICS OF THE URBAN POOR

Overview of the Urban Poor

Before *doi moi* (renovation) was officially introduced in 1986, Vietnam was an economically poor country. While a majority of the poor lived in the rural areas, the urban poor only made up about one fourth of the total poor. It has been documented that there is a close relationship between the rural poor and the urban poor. Farmers who lack land or lose land often look for economic opportunities elsewhere and become a pool of the poor who are ready to join the urban poor. However, the urban poor is a complicated social issue which relates to many different factors in an endless moving and developing socio-economic environment in cities (Mai 2009), though the urban poor does not form a large percentage of the poor in Vietnam in

general. According to the official statistics, less than about 10 per cent of the poor in Vietnam reside in urban areas. However, this figure may be lower than the real level and rate.

In the context of the global economic crisis, bringing negative impacts to all levels of society, the poverty reduction in urban areas becomes more complicated. To better understand the complicated issue, it is necessary to question who the urban poor are and how they have been confronting the difficulties to help themselves and their families to exist. Within the limited availability of data and information, the chapter focuses on some basic characteristics of the urban poor and the effects of the economic downturn on their employment, income, and difficulties they have to confront.

Before *doi moi* a large part of the urban population worked in government agencies, earned monthly wages, and enjoyed subsidies for housing and food. In compliance with the socialist republic model in the 1970s and 1980s, the cities had no slums, no free migrants from rural areas, no spontaneous construction, and no obvious gaps between the rich and the poor (Mai 2002). With the introduction of the *doi moi* policies in the late 1980s, Vietnam's market economy has emerged and developed, resulting in high economic growth. It accelerated the process of widening the gap between the rich and the poor. In poor areas where housing conditions are worse, poor infrastructures have become more obvious in urban areas of today's Vietnam.

The migrants may reduce the poverty for their families by sending wages that they earn in urban areas or investing in production and improving their housing conditions. Many studies indicated that migration is a living strategy for most rural family households, including the poor households (Ngoc 2009). The rural poor are a pool of potential urban poor. In other words, some urban poor originate from the rural areas.

There are usually three categories of urban poor. The first is the category of urban dwellers who have lived there for many generations. Their jobs are non-farming, and they have urban lifestyles. The second is the category of poor people living in suburbs. When the cities are extended they become urban dwellers. Their jobs are agricultural and non-agricultural; their lifestyle is a mix of rural and urban ones. The third category is poor people who migrate from rural areas. Most of them are farmers who migrate freely from rural to urban areas (excluding those who migrated as planned migrants under the government's resettlement programmes). Their jobs are non-farming, but most of them are free-labour, unskilled labour, and have rural lifestyles. The poor living in suburbs and the poor migrating from rural areas are often called the new poor as they have just emerged in the open-door era, when Vietnam adopted the market-economy and joined the international integration.

In major cities such as Hanoi and Ho Chi Minh City, the poor live in the inner urban areas close to their places of work. This helps reduce the costs of their daily transport to work. Those without stable jobs and income usually live in poor areas characterized by temporary and squatter houses, connecting to poor infrastructures and a polluted environment.

Education, Skills, and Employment

The urban poor usually work as at-home merchants, small service providers, free labour, wage earners in production bases, or workers in state-owned or private enterprises and factories. Their jobs are dominated by unskilled roles that do not require professional skills (Mai 2002). Most of them are free labour, unstable, uncertain and low earning. One study on the poor in Hai Phong shows that about half of the poor were doing work that required no technical skills (Mai 2002). The urban poor experienced a high rate of unemployment or underemployment. A study by the Central Institute for Economic Management (CIEM 2006) also showed that the urban labourers were usually confronted with underemployment; though they had jobs, they still wanted to be able to work extra.

The unemployment of the urban poor is more prevalent than that of other income groups. Mai (2002) found from a survey of the ten poorest wards in Hai Phong, the lowest-income group has a rate of unemployment 2.5 times higher than that of other better-off groups (15.8 per cent compared with 5.5 per cent). The rate of unemployment in the poor group in Ho Chi Minh City is slightly higher (20.2 per cent of the total 915 interviewed people of a working age). Among the unemployed people, there is a portion of government-officers, civil servants who stop working due to personnel downsizing. As mentioned earlier, the new poor consist of poor people from the suburbs or rural migrants. This is another reason for the rate of unemployment among the urban poor being higher than the normal rate.

The nationwide rate of literacy was quite high because the education development policy of the government has made remarkable achievements (about 91 per cent of the population at least ten years old according to the 2009 Population and Housing Census of Vietnam). Therefore, the poor as well as the better off all have opportunities to improve their education and training. However, the education of the urban poor is usually lower than that in other income groups. A study on the poor in Hai Phong indicated that the percentage of those with primary education among the poor group is approximately half of that in the highest income group. The lowest income

group (the poor) has a rate of illiteracy eight times higher than that of the well-off group (Luan 2003).

Income, Expenditure, and Debts

Economic crisis forces the majority of households to reduce their spending, both in living expenses and investment. The income of the urban poor is usually low and uncertain (only a few have retirement pensions or have long-term employment contracts, etc.). In terms of expenditure, their expenses for food account for 73 per cent of total monthly expenditures. About 15 per cent of expenditure is for children's education fees, with the remainder for health care and other needs such as clothes, electricity, water, cooking fuel, etc. That means that about 90 per cent of the low-income households cannot balance the income-expenditure and they have to borrow and be in risk of poverty (World Bank 2009). These debts are often a vicious circle that have trapped near-poor and poor households during the economic slowdown.

Many Dependents and Lack of Labour

Poor households usually have a large number of children, or weak, old, sick, disabled members. They are not only in poor health but also have chronic diseases. Because they lack manpower, poor households usually have more dependents and mouths to feed than non-poor households do. Women-headed households accounted for 24.5 per cent of the urban poor (Luan 2003). The husbands may have died or divorced and remarried. The households become poor due to a lack of main labour and income-generating activities.

Vulnerability

The poor households are vulnerable to difficulties that are seasonal but incidentally changeable to their family or community. Any potential risk such as sickness, unemployment, natural calamities, etc. may threaten the lives of the poor. All compulsory expenditures for medicine, health examinations and treatment, or education fees for children are borrowed and are difficult to pay back. In particular, if the family has a sick member, it is considered a serious event that threatens the family's well-being and it may take years for them to recover from the crisis.

Issues such as dwelling relocation and resettlement happen in the community, but poor households are usually the last people to be informed because they are not reached by local authorities. Drugs, prostitution, violence,

and so on occur in the neighbourhood and are likely to threaten the safety of poor children. It has been reported that some poor households — for example, the impoverished settlers — have no permanent registration and can neither participate in community meetings nor attend such meetings (Ngoc 2009). Without urban residential permits, these households encounter difficulties in accessing public services in the urban areas (Anh 2005).

IMPACTS OF THE ECONOMIC DOWNTURN ON THE URBAN POOR

The global economic crisis has negatively affected the socio-economic development of Vietnam in many sectors and at different levels. The Vietnamese economy, of which exports plays an important role, is heavily affected. The export markets of garments, electronics, sea products and so on have declined significantly (Campbell 2009). Production sectors such as garments, textiles, and leather, that make use of the domestic unskilled labour, suffered much with the appearance of the surplus in the young labour force. They became jobless and faced difficulties to change to other sectors because of their poor qualifications and lack of skills.

Consequently, people's livelihoods were threatened. Low-income families had to confront many difficulties in employment and income to survive. People were affected by escalating prices of food and fuel. Families or individuals living close to the poverty line are likely to fall into poverty, meanwhile the conditions of the poor continue to deteriorate.

Employment and Income Status

Losing Jobs, Lack of Jobs

Due to the economic downturn, limited investment capital, and narrowed markets, producers and manufacturers have to reduce labour costs. Workers are at risk of being laid off, particularly those working in the construction or manufacturing sectors. It is very hard for jobless workers to find new jobs. As reported by the General Statistical Office (2009), 1,030,000 people were jobless in 2008. The rate of unemployment in urban areas did not change significantly. It was 4.64 per cent in 2007 and 4.65 per cent in 2008. Because a number of those made redundant found temporary employment in the urban informal sector, the rate of unemployment may not increase.

Although job training for labourers is included in the poverty reduction and hunger elimination policy, during the economic recession job training centres received very little support for the creation of new jobs. According to

the director of the Hanoi Job Promotion Centre, at the end of 2008, at his centre, there was only 3–4 thousand vacancies compared to 6–8 thousand at the beginning of the year (Campbell 1999). The export of labour has been affected and slowed down due to the declining need for overseas foreign workers. In the labour receiving countries, due to the impacts of the economic downturn, the unemployment rate has increased rapidly. Some countries prohibit enterprises from hiring overseas labour in order to prioritize jobs for local people (Malaysia, for example), or reduce the number of overseas workers. Both cases reduce employment opportunities for Vietnamese labour deployed overseas. New jobs become fewer; opportunities of income-generating work reduce and become rare to the urban poor.

As revealed by some statistics, about 67,000 workers in enterprises in the country lost their jobs, mainly in three cities: Hanoi, Da Nang and Ho Chi Minh City (Ngoc 2009). However, part of the workforce could not sign labour contracts, hence they might not be counted in this figure. The three groups of workers that are mostly affected are reported as migrant workers, non professional or unskilled labour, and seasonable labour (Anh 2009). They are considered the near-poor group and can fall into poverty as the result of the economic recession. The number of poor households increases as the household heads or main earners lose jobs and incomes. The economic crisis has brought adverse impacts on the life, income, and employment of near poor and poor households.

Working Hours Cut and Reduced Wages

The employment of poor workers becomes more uncertain. Their incomes are reduced and become unstable during the economic downturns. Their wages are not paid due to the financial loss of enterprises. The uncertainty in employment and income is also characterized by other forms such as a reduction of working hours or working days. It was found that though reduced hours were common in industrial zones in early 2009, official dismissal was often not reported (Ngoc 2009). Non-renewal of contracts and encouraging employees to quit are more often used to reduce the number of employees. The reduced wages are too low to cover the substantial needs of workers and their families. Some enterprises try to keep contact with the employees with the hope that they will not have to recruit new workers and retrain them after the economic crisis is over.

In fact, dismissing workers is not a solution that employers may opt for because it may worsen relations with workers and cause unstable conditions for the enterprises. In order to avoid such a situation, some employers prefer

reducing working hours or the monthly wage of workers. In the first six months of 2009, there were even enterprises that are recognized as having recovered production. There were even factory workers who only worked two hours a day and only received a small amount of remuneration from their employers (World Bank 2009). Therefore, workers were confronted with two options: unemployment or reduced working hours. Either option entailed a reduced income.

Lowered Standards of Living

Because of uncertain and potentially lowered income, the standard of living of labourers more or less decreased. As a domino effect, the decreased income of the labourers affects the lives of their family members. In addition, prices inflate, particularly those of food, water, electricity, fuel, house rental, affecting the lives of all in the society. Households have to follow the "saving" mode, lower consumption and only spend on essential needs while cutting down others. Some households use loans to smooth consumption, which can be a short-term remedy. However, it can have long-term negative consequences in terms of heavy debts arising from the high interest.

Though the government has made great efforts, such as adjusting the basic salary to be applied in enterprises in early 2008, increasing the subsidy to retired and policy beneficiaries, due to the high current rate of inflation, the lives of most urban dwellers are affected. Urban poor households are confronted with greater financial difficulties than other households. The solution that all poor wage-earners have to apply is to cut expenditures, tighten their belts, prioritize essential needs such as foodstuffs, electricity, water, and cooking fuel. These adaptation strategies are harmful, and the economic difficulties cause immeasurable consequences to the lives of poor labourers. The final impact that the urban poor have to bear is the decreased living level.

Vulnerable Social Groups

Children

The economic difficulties affecting the poor in Vietnam do not spare the children. The economic downturn has resulted in unsecured employment and lower and unstable income. Cutting and narrowing expenditures is one of the strategies used by most households. Children might have to leave school due to economic difficulties. Dropouts not only do housework but

also assist parents in selling goods, or participate in economic activities to contribute to the household income. A recent assessment indicated the cut-off of extra studies among children of the affected households (Anh 2009). These households could not manage to pay for the fees and hence their children had to drop out from tuition classes.

Children are also at risk of violence. Their parents may be worried and tense about their income, tired from work, and feel disposed and lack confidence. These stresses can be passed on to their children who become victims of domestic violence. The affected households are likely to fall into a vicious circle. Because they are poor, they are unable to cope with the economic crisis, losing jobs and having low incomes, suffering high prices, loans and debt. As a consequence, the number of the urban poor, including children, has increased.

Women

Female labourers make up about half of the labour force in Vietnam. However, available studies indicate that women are usually more disadvantaged than men in the labour market (Minh 2006, World Bank 2009). Having to accept work for a relatively lower wage and in much harder conditions, women were largely represented in the low- or unskilled jobs, as well as informal sector jobs.

Gender impacts can be seen from different ways. The export-led economic growth showed its weakness during the collapse of overseas markets. Declining exports seriously affected production activities. It affected the labour markets negatively, and more severely the female workers than their male counterparts. As female workers made up a high proportion in the garment, seafood, and leather sectors, they were most affected by the crisis. Migrant workers for export manufacturing were hit hardest by the crisis, and their remittances were falling, especially migrant women. Because the migrant women were mostly from low- or unskilled groups, they became most vulnerable to job dismissal and wage reduction.

Women are also subject to social evils and abuse, particularly young women. They are often defrauded with empty promises of employment, and then forced into prostitution or intravenous drug use. They are at risk of human trafficking to urban areas or overseas to be illegal wives, etc.

Migrant Workers

As mentioned above, migrant workers are a large and indispensable part of the urban poor in Vietnam. As reported by the Central Institute for Economic

Management (2006), the amount of work available for farmers was about 180 labour days per year, i.e., about 80 per cent of the total labour time. Therefore, they move to find work in urban areas during the off-season.

Due to difficulties in finding jobs, a large number of migrants explore ways to remain in urban areas in the hope of finding work. They do all manner of jobs, such as selling lottery tickets, operating taxi motorbikes, cutting hair, dealing scrap iron and bric-a-brac, etc. They have joined a large group of peddlers, motorbike taxi drivers, goods carriers that are already subject to being driven away or limited in their operations by the urban authorities (Anh 2009). With little income, migrant workers in urban areas will potentially join the ranks of the poor. In addition, some young migrants, due to unemployment or underemployment are at risk of joblessness.

Some migrants, after a great effort, failed to find jobs in the urban areas. They returned to their hometown in order to save costly rental and living expenses. For example, in Hanoi's Plastic Company, many unemployed workers had to return home to rural areas and reduced the labour availability in the cities (Campbell 2009). A report released by the World Bank (2009) considered that "labourers returning home are not as many as they are expected, it seems that migration cannot be reversed. People who have to return home seem to encounter more difficulties than they normally expect."

The economic decline made income sources of many migrant workers smaller because they had no extra work payment and their jobs were frequently scaled down. The labourers had to reduce and cut expenditures, particularly in large cities such as Hanoi and Ho Chi Minh City because the living costs are high and prices of basic goods are rising. Accordingly, the amount of money sent back to their households in the villages was also affected (Anh 2009).

As mentioned above, the housing situation for low-income people in the cities was miserable, both in terms of quantity and quality available. Migrant workers have to pay high rentals because the housing prices had increased. They could only afford to stay in cheap houses with poor conditions (no toilet and narrow area) in slums with degraded infrastructures such as sluices, over-road drainage ditches, waste water, and water-logging, or they shared with others in order to reduce costs. Migrants usually had to pay higher prices for water and electricity than the urban dwellers did. What was already a housing shortage became a situation of serious insufficiency.

Although there have been many changes in policies for migrants, when they become sick they usually use private health care services and have to pay higher prices because they lack the necessary papers such as civil register book and health insurance to access the public health bases. Some poor migrants have health insurance registered in their homeland, but it is not easy for migrant workers to return home for treatment when they are sick (Ngoc 2009).

CONCLUDING REMARKS

Impact of the Crisis

Most of the urban poor had limited knowledge, were small merchants, or offered at-home services and free labour; a small number of them earned wages and worked in state-owned or private enterprises. Most of their jobs were low-paying jobs, requiring low or no skills. Poor households usually had a large number of children, lacked income-generating labour, and had many dependents; their income was low and uncertain. Expenditures for foods made up about 73 per cent of total monthly expenditures of poor households. Most poor households had to spend more than they could earn, therefore they had to borrow and were likely to fall into poverty and hunger. They lived in poor quality housing with degraded infrastructures and hazardous environments. Therefore, the urban poor were more vulnerable to seasonal difficulties, unexpected events such as natural disasters, floods, and storms, particularly in case of sickness and job loss. For these families it was difficult to make ends meet and they hardly had an opportunity to participate in community activities, such as public meetings. The urban poor, particularly migrant workers, usually encountered difficulties in accessing public services in cities such as heath care and treatment as well as children's schooling.

In the context of large budget and current account deficits as well as high inflation in Vietnam over the last couple of years, special care should be taken to ensure that recovery is fast, but also sustainable. The socio-economic conditions for poorer groups has deteriorated. Employment for the urban poor is unstable due to redundancies, reduced working hours, delayed or non-payment of wages. Reduced wages results in lower incomes and changing living conditions for family households. A large number of near-poor households with low income fall into poverty; meanwhile, the poor become poorer. Consequently, the number of poor households in urban areas were likely to have increased. Children, women, and migrants were most vulnerable and less protected under the crisis. The illegal use of child labour tended to increase because of the lack of intervention. Younger children were at risk of being violated by employers, while older children were susceptible to violence and social evils such as robbery, the drug trade, or addiction. Women were also vulnerable as they were more likely to be laid off than men. Similar to children, they were more likely to become victims of human trafficking, sex work, or the drug trade.

Migrant workers form a large part of the urban poor, with unstable and seasonal employment. They usually performed unskilled jobs that lacked workmanship; their wages were unstable and low, and they had to compete with existing workers in an increasingly tightened informal sector. Due to

their low income, the migrants often lived in poor, temporary, and degraded houses. The migrant poor also faced difficulties in access to public services. They usually had to pay higher costs for health examinations and treatment, for use of water and electricity, because they were not granted permanent registration status in the destination areas.

Policy Interventions

In response to the economic downturn, the government enacted many policies to assist laid-off workers and the unemployed, including the urban poor. First it implemented Decree no. 33/2009/NĐ-CP: from 1 May 2009 the basic labour salary increased from 540,000 dong per month to 650,000 dong per month (an increase of about 20 per cent; GSO 2009). Second, it carried out the unemployment insurance programme that is regulated by the Law on Social insurance, becoming effective from February 2009. Third, it used the government's stimulation package to support investment, including to small and medium enterprises to develop production, and create more jobs (Campbell 2009). And fourth, it started the programme on social housing for low-income people, including students and migrants in the industrial zones.

The government responded by reversing the course of monetary tightening and the fiscal austerity policy implemented in 2008. To stimulate the economy, the government also put in place a large fiscal stimulus package. The government has already introduced measures to protect low-income workers struggling to cope with poverty. Under the stimulus package, a cash assistance programme for poor households was implemented. Basic cash subsidies were distributed right before the Tet festivities in early 2009 to the grass roots communes. Unfortunately, these could not reach poor households properly due to the poor management of local authorities. A large number of poor households did not receive the assistance, while non-poor households could get the subsidies. This has hampered the purpose of social relief and weakened the transparency of the stimulus package.

This chapter only addresses some of the issues that labourers, particularly poor labourers living in urban areas, are confronted with. Due to restrictions on information and statistical data, some other social dimensions have not yet been touched upon.

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15

HIGH COST OF LIVING AND SOCIAL SAFETY NETS FOR LOW INCOME GROUPS IN URBAN SARAWAK, MALAYSIA

Ling How Kee and Wong Swee Kiong

Steady economic growth in the last four decades in Malaysia has successfully resulted in a decline of poverty incidence from 52.4 per cent in 1970 to 6.1 per cent in 1997 (Nair 2005), though regional, ethnic and rural-urban disparities remained. However, due to the impact of the 1997 Asian financial crisis, poverty incidence rose for the first time to 8.5 per cent in 1998 (EPU 2001). Nevertheless, the government managed to restore the economy by introducing strict fiscal policy, stimulating the market, and stabilizing the financial market (JBIC 2001). Consequently, the incidence of poverty was reduced to 5.7 per cent in 2004 and then to 3.6 per cent in 2007 (EPU 2009*a*).

However, the recent spike of inflation threatens to push low-income families in Malaysia below the poverty line. Based on a Bank Negara Malaysia (2008) report, the inflation rate in Malaysia as measured by consumer price index peaked in the third quarter of 2008. The inflation rate moderated to 3.9 per cent in January 2009 from its elevated level due mainly to the series of downward fuel price adjustments by the government and the more moderate increase in food prices (Bank Negara Malaysia 2009). However, declining inflation only means a declining rate of increase of price level. The price level

of goods and services remains very high and rising, implying a continuously higher cost of living, even during recession. On the other hand, the GDP growth rate in Malaysia in 2008 (at 2000 constant price) was 4.6 per cent. Due to the recent global recession, the growth rate dropped drastically to –6.2 per cent in the first quarter of 2009 and improved slightly to –3.9 per cent in the second quarter of 2009 (Department of Statistics 2009).

With this rising cost of living and declining growth rate, it is surmised that low-income groups, particularly those with large families in urban areas, feel the pinch. According to studies conducted by Ragayah (2002, 2004), urban households were more affected by the rising commodity prices compared to those in rural areas as the latter were more able to diversify their income sources and to turn to local food production to cushion the effects of rising costs. The questions to arise are: How does the high cost of living impact on the quality of life and the well-being of the low-income families in the urban areas? How do they cope? What are the social support systems available to help tide them over this difficult period? Are the existing social safety nets available to them?

This chapter examines the impact of the high cost of living on low-income groups and families in the urban regions of Sarawak, Malaysia. The discussion is based on data obtained from a study conducted between January and June 2009 in and around the vicinity of the capital city Kuching and around the town centre of the Samarahan Division. The objectives of the study were to explore how low-income families are affected by, and cope with, the rising cost of living, and whether existing social safety net programmes are available to them. Purposive sampling was used to select and interview groups of people in the lower rung of the occupation ladder and whose incomes are below RM2,500. The chapter discusses the implications of the findings on the existing social safety net and concludes with several recommendations on appropriate social security provisions for the lower income groups.

As postulated that urban low-income families face the risk of falling into poverty in the face of the current economic recession and rising cost of living, it is appropriate to examine poverty in Sarawak particularly urban poverty before we discuss the study.

POVERTY IN SARAWAK, MALAYSIA

Malaysia introduced and adopted the poverty line income (PLI) to measure poverty since June 1977. Taking into consideration some of the limitations of the 1977 PLI approach, a revised methodology for PLI based on the Household Income Survey (HIS, or HES), which reflects the size, demographic

composition as well as the location of households, has been used since 2005 (Ragayah 2007; UNDP 2008). Since then, the HIS, which is carried out by the Department of Statistics Malaysia twice in every five years, is used as the basis for official measures of poverty incidence in Malaysia (UNDP 2008). In calculating the PLI, a distinction is made between food and non-food components (UNDP 2008). A household is considered poor if its income is less than its own PLI (comprising both food and non-food PLI components), which means that it lacks resources to meet the basic needs of its individual members in the household, whereas a household is considered hard-core poor if its income is less than the food PLI component[1] (Ragayah 2007).

PLI in Sarawak is consistently set on a higher level than Peninsular Malaysia taking into account the higher cost of living. Table 15.1 shows the comparison of PLI in Sarawak, Sabah, and Peninsular Malaysia in 2007/2008.

Sarawak is one of several states with a higher incidence of poverty; the others are Sabah, the east coast states (Terengganu and Kelantan), and the states in the northern region (Kedah and Perlis) of Peninsular Malaysia (Malaysia 2006). In the last two decades poverty reduction has been remarkable, declining from 21 per cent in 1990 to 7.5 per cent in 1997, and 5.8 per cent in 2002. Hard-core poverty has also successfully been reduced from about 11,100 households (3.3 per cent) in 1990 to about 2,400 households, which accounted for 0.6 per cent in 2002 (EPU 2009*a*) (see Table 15.2).

TABLE 15.1
Poverty Line Income for Sarawak, Sabah, and Peninsular Malaysia, 2007/2008

Regions	*Poverty Line Income (PLI) (in Ringgit Malaysia)*			
	Poor		*Hard-core Poor*	
	Household	*Per capita*	*Household*	*Per capita*
West Malaysia	720	180	430	100
Urban	740	185	420	100
Rural	700	160	440	100
Sabah & Labuan	960	200	540	110
Urban	970	200	540	110
Rural	940	190	540	110
Sarawak	830	190	520	115
Urban	860	190	530	120
Rural	810	190	500	110

Source: EPU (2008).

TABLE 15.2
Incidence of Poverty in Sarawak by Region, 1990–2007

Year	*Poor*				*Hard-core Poor*			
	Total (%)	*Urban (%)*	*Rural (%)*	*Total Household ('000)*	*Total (%)*	*Urban (%)*	*Rural (%)*	*Total Household ('000)*
1990	21	4.9	24.7	70.9	3.3	0.6	3.9	11.1
1995	10	3.0	15	66.5	2.6	0.6	3.3	10.2
1997	7.5	2.0	11.63	30.4	0.7	0.2	1.2	3
2002	5.8	1.7	10	22.8	0.6	0.1	1.1	2.4
2004	7.5	1.7	12.9	34.8	1.1	0.1	2.1	5.1
2007	4.2	2.3	6.3	20.6	0.7	0.1	1.4	3.6

Source: EPU (2009*b*).

However, the revised PLI of 2004, which includes both food and non-food items as well as taking into account the size and demographic component of households, had risen from RM600 in 2002 to RM765 in 2004, thus increasing the incidence of poverty in Sarawak from 5.8 per cent in 2002 to 7.5 per cent in 2004 (EPU 2004). The incidence of poverty in urban areas has shown a reduction from 4.9 per cent in 1990 to 1.7 per cent in 2002 and remained at 1.7 per cent in 2004 but had risen to 2.3 per cent in 2007. Hard-core poverty has been successfully reduced from 0.6 per cent in 1990 to 0.1 per cent in 2004 and remained the same in 2007.

On the other hand, although the incidence of poverty is low in the urban areas compared with that in the rural areas, the poverty reduction rate in urban poverty is not as remarkable as compared with rural poverty, and in fact as shown in Table 15.2 there was an increase in urban poverty incidence in 2007 at 2.3 per cent compared to 1.7 per cent in 2004; similarly for urban hard-core poor, there is no reduction and it remains at 0.1 per cent. Experiencing rapid economic and social transformation over the last three decades, Sarawak has noted an increasing trend of urbanization (Abdul Majid Mat Salleh et al. 1990; Hew 2003). As noted in studies conducted in other parts of Malaysia, excessive urban growth in general and concentration of people and economic activities in the large urban areas not only leads to increasing urban diseconomies and escalating social costs but also aggravated urban poverty (Chamhuri and Mohd Yusof 1997).

In view of the current economic crisis and rising food prices, a study focusing on urban low-income groups is therefore of great relevance and importance.

BACKGROUND TO THE STUDY

Previous studies have shown that in times of financial crisis such as in 1997–98, urban households were more affected than rural households (Ragayah 2002, 2004; Sity Daud 2000). Rural households have been able to diversify their income sources and even experienced an increase in net income, while urban households may face the threats of pay cuts and even retrenchment. In the face of price hikes in fixed cost necessities such as food and utilities, all households will suffer a loss in disposable income; however, low-income urban households will suffer more a decline in their quality of life.

Based on this premise, a study was conducted between January and June 2009 in two urban regions of Sarawak: (1) the capital city Kuching and the sub-district Kota Pedawan, 16 km from Kuching, and (2) Kota Samarahan, a fast growing town 30 km from Kuching and the administrative headquarters of Samarahan division. In terms of selecting the respondents, the revised 2005 PLI methodology of determining who are in the low-income category was adopted. This means a household is considered poor if its income is less than its own PLI — which includes food and non-food expenditure in accordance with the family size and demographic composition. For instance, a household with a family size of 12 members on a monthly income of RM2,280 can still be considered poor based on this 2005 PLI methodology. We also take into consideration the Department of Statistics household expenditure survey 1998/99 which revealed that the average expenditure per urban household was RM1,943 and RM1,270 per rural household (cited in CPPS 2006). In addition, other studies in Malaysia have suggested a minimum of between RM1,000 and RM1,500 per month in order to live adequately, arguing that the current official figure underestimates the number of poor in the country (Goh 2005, Nair 2005). It is also noted that in some contexts in Malaysia a distinction is made between those who are poor and those who are from low-income groups. The former refers to those who live below the PLI, while for the latter a figure of between RM2,000 and RM2,500 (CPPS 2006). Therefore while the PLI of RM860 for a family of five is used as a guide, a more flexible approach of selecting respondents from commonly known low-earning occupational groups was adopted, with the additional criteria that the family income fall below RM2,500 a month. The main aim was to explore how inflation affected their lives and how they coped with it.

Using a structured questionnaire and a purposive sampling procedure in order to elicit respondents from a range of different occupations and mix of gender, age groups, and ethnicity, 478 respondents were interviewed. Table 15.3 shows the distribution of the 478 respondents according to occupation.

TABLE 15.3
Distribution of Respondents Based on Occupations

Occupation	*Frequency*	*%*
Agricultural product seller/Goods vendor	10	2.09
Army	15	3.14
Bulldozer/crane operator	5	1.05
Bus Driver	16	3.35
Cashier/Account clerks/Ticketing clerk	8	1.67
Cleaner	55	11.51
Clerk/Typist	24	5.02
Construction worker	22	4.60
Cook/drink maker/Bread/bun maker/Dish washer	11	2.30
Factory worker	20	4.18
Fireman	3	0.63
Gardener	8	1.67
General worker	21	4.39
Helper/Childminder	9	1.88
Lorry/van driver/Boatman	9	1.88
Mechanic/Technician/Welder/Carpenter	12	2.51
Medical attendant	2	0.42
Petrol pump attendant	15	3.14
Postman	4	0.84
Promoter/Decorator/Tailor	7	1.46
Security guard	26	5.44
Shop attendant	113	23.64
Street sweeper/Waste collector/Toilet cleaner/Car washer	5	1.05
Waiter/waitress	58	12.13
Total	478	100

Source: Calculated by the authors.

In terms of their income, as shown in Table 15.4, over half of them, 55.2 per cent (264 respondents), were drawing an income of between RM501 and RM1,000; 15.9 per cent (76 respondents) were on an income of RM500 or below.

Almost all the respondents (94.14 per cent) have dependents, ranging from 1 to 12, some of these included their parents (refer to Table 15.5). The remaining 28 respondents who have no dependents are single; however, the majority of them claimed that that they have to help support family, particularly ageing or ailing parents or younger siblings with part of their income.

TABLE 15.4
Distribution of Respondents by Income Level

Number of Respondents According to their Income Level

Income Level	*Frequency*	*%*
Below RM500	76	15.9
RM501–1,000	264	55.2
RM1,001–1,500	75	15.7
RM1,501–2,000	50	10.5
RM2,001–2,500	13	2.7
Total	478	100.0

Source: Calculated by the authors.

TABLE 15.5
Distribution of Respondents Based on the Number of Dependents

Number of Dependents	*Frequency*	*%*
None	28	5.86
1	20	4.18
2	51	10.67
3	85	17.78
4	88	18.41
5	81	16.95
6	71	14.85
7	31	6.49
8	12	2.51
9	8	1.67
10	2	0.42
12	1	0.21
Total	478	100.00

Source: Calculated by the authors.

In-depth interviews were further conducted with 38 of these respondents to obtain qualitative data. They were selected following a purposive sampling method aimed at identifying respondents from diverse ethnic backgrounds, age groups, occupation, and life experiences and included people of both gender. Existing social safety nets were examined to assess whether they are a source of support for people in need at a time of economic downturn.

Information on various social safety net schemes provided by the government, especially the Social Welfare Department, the urban poverty eradication scheme administered by the municipal councils, were solicited from the respective departments. Eligibility criteria and the recipients were explored; and some attention was directed at those who applied for the assistance schemes but were not approved. The particulars of these groups were used to compare with those of the respondents to enable us to better assess whether the criteria of the current assistance schemes may have to be adjusted if they are to really benefit those who are in need.

IMPACT OF RISING COSTS ON THE LOW-INCOME GROUPS

In the main, the respondents interviewed revealed that they are affected by the rising costs. Data on their monthly expenditure before and after the rising costs (that is before January 2009) were obtained. For analysis purposes, the distribution of respondents according to an aggregated amount of expenditure before and after the rising costs is shown against the aggregated number of respondents of different income level as in Table 15.6. It is noted that the respondents' income stayed within the same range before and after the rising costs, even for those who have taken up overtime jobs.

The table shows that there is a slight increase in the number of families in the two highest categories of expenditure; in the RM1,501–RM2,000

TABLE 15.6
Distribution of Respondents Based on Total Monthly Income and Expenditure Level before and after Inflation, 2009

Income/Expenditure	*Current Income Level*		*Expenditure Before Inflation*		*Expenditure After Inflation*	
	Frequency	*%*	*Frequency*	*%*	*Frequency*	*%*
Below RM500	76	15.9	104	21.8	94	19.7
RM501–1,000	264	55.2	228	47.7	233	48.8
RM1,001–1,500	75	15.7	101	21.1	98	20.5
RM1,501–2,000	50	10.5	38	7.9	41	8.5
RM2,001–2,500	13	2.7	7	1.5	12	2.5
Total	478	100.0	478	100.0	478	100.0

Source: Calculated by the authors.

category from 7.9 per cent to 8.5 per cent and in the RM2,001–RM2,500 category from 1.5 per cent to 2.5 per cent. There is also an increase in the number of families in the next-to-lowest category of expenditure, RM501–RM1,000, from 47.7 per cent to 48.8 per cent. Although this does not appear to be significant, the data may indicate the rising expenditure among the respondents. Further analyses of how they cope with the rising costs may reveal important areas of concern.

More than half of the respondents (52.2 per cent) in our sample indicated that their total monthly expenses increased in the previous 6 months; 40.6 per cent reported that they had to reduce their total monthly expenses, while 7.2 per cent of respondents said they tried to maintain the same total monthly expenditure (see Table 15.7). In both cases they had to resort to cutting down on certain expenditures or to forgo some of the important expenses, such as children's education, private medical care, and entertainment expenses.

TABLE 15.7
Impact of Rising Living Cost on Total Expenditure

Impact	*% of Respondents*
Increase in total expenditure	52.2
Decrease in total expenditure	40.6
Total expenditure unchanged	7.2

Source: calculated by the authors.

Many of them reported that one way they cut down their expenditure is by forgoing certain food items, for example protein-rich food and imported fruits. They also switched to cheaper brands of rice which they felt made a substantial difference when they have so many mouths to feed. It is apparent that they recognize that food is a necessity which they cannot forgo; however, it is not certain whether cutting down on certain food items and switching to different food may sacrifice the nutritional needs of growing children.

Several respondents stated that they had to reduce their number of trips to town to buy their daily necessities in order to cut down on fuel costs. A number of respondents said that they could no longer send their children for tuition classes as they needed the money for the more expensive basic necessities, particularly food. Some families just ignored their children's requests to purchase stationery or reference books as they could not afford

those items. There were also a few respondents stating that they were unable to send their children to private clinics but had to wait in long queues in the general hospital to get treatment, even though their children were very sick. Some had mentioned that they needed to work overtime or take up another job by sacrificing their rest hours in order to cope with the increasing living expenses. The following vignettes serve to highlight the difficulties experienced by respondents selected from different occupational categories, from a mix of gender, ethnicity, and age groups.

Kintok[2] a 50-year-old Bidayuh man, who earns a living as a bus driver, typifies the plight of those with a big family hard hit by the rising living expenses. With a monthly salary of RM680 and twelve dependents to support, he is particularly stretched. His monthly household expenditure amounts to RM980. On average he needs to spend about RM500 monthly on food, RM180 for transportation, RM200 on other expenditure such as electricity and water bills, and RM100 for the children's education. He has no other alternative but to work additional hours, often up to 72 hours a week, so that he is able to use the overtime claim to help support his large family, particularly when the prices of almost all things are rising.

Another bus driver, Shukree, married with three children, is in no better position. Forty-three-year-old Shukree faced much difficulty living in Kuching with gradually higher costs of living on his earning of only RM565 per month. Shukree claimed that as a Malay Muslim, he adopts a simple lifestyle, but he still needed to spend about RM600 for food, RM60 for transportation, RM150 for his children's education, and RM80 for other expenses every month. Thus, he is forced to sacrifice his rest time and even health to work 70 hours per week to get extra income to pay for the rising costs of all goods and services.

Koo, a Chinese man at 60 who, although having worked as a bus driver with the same bus company for thirty years, does not fare better than the two men above. While people at his age may have retired from work he could not afford to do so as he has to support his family with four dependents. He still works as long as 78 hours to get extra income to finance an average expenditure of RM800 per month for food, RM150 each for transportation, children's education, and other expenses in his family. He realized that he is very much underpaid at a monthly income of RM550, and despite his long service in the same bus company, he has not had any increment of salary. On the other hand, given his age coupled with a lack of occupational skills and a primary-level education, Koo has no choice but to stick with his current job and take up overtime to earn extra income to support his family.

Another respondent, Stanley, a 39-year-old Iban man, is grateful for his wife who helps to earn extra income by taking up a waitress job at the same coffee shop he works in so that they can cope with the rising living costs. As a drink maker at the coffee shop, his monthly income of RM700 would not have been enough to support the family with three children aged 13, 10, and 9. Stanley's eldest son even works as a part-time worker at the same coffee shop when the shop needs more workers, particularly during weekends. Stanley shared an unforgettable experience when their second son suffered asthma one time and they did not have any money left to bring him to see a doctor. His wife was forced to sell off her wedding ring for the son's medical expenses even though the ring has so much sentimental value to her.

Stanley's family situation highlights the lack of savings for low-income families who have to resort to selling their valuables in times of rainy days. Another point that arises is the accessibility of public health care, which is a recurring issue when we consider the needs of low-income families.

The situation of Nyaweh, a 52-year-old Bidayuh woman who earns RM500 a month working as a school cleaner, is most illustrative of a family in dire need of medical health care and income support. Nyaweh has to support her husband who has not been able to work for three years due to suffering pain in his right knee. She has to spend about RM1,000 every six months to purchase the medicine and needle to extract the unwanted fluid from his knee. Their adult children who have their own families to support are not providing them with any financial support. Nyaweh and her husband grow their own vegetables and only buy and consume chicken or fish once every fortnight in order to cut down expenditure on food. They had approached the Social Welfare Department for financial assistance but were always told to wait. During the interview, Nyaweh expressed her loss of hope for any kind of assistance from government departments.

When asked whether they have approached any organizations for financial assistance or other forms of support, most replied in the negative (see Table 15.8). Although they are aware of some of the financial assistance schemes provided by the Social Welfare Department, based on their knowledge, only those who are disabled or chronically sick are eligible. It appeared that support, if any, is from within the families and local communities.

Forty-year-old Peter who works as an office junior assistant in a private company, is appreciative of his mother's contribution in defraying the family food bill. Drawing a monthly income of RM700 and having to support his wife and five children, ranging from age 4 to 15, he is experiencing hardship

TABLE 15.8
Percentage of Respondents Who Have Accessed Different Sources of Financial Assistance in 2009

Source of Assistance	*Percentage of Respondents who have accessed it*	*Percentage of Respondents who have never accessed it*
Government	5.86	94.14
Non-government Organizations/ Religious Body	0.42	99.58
Relatives	17.99	82.01

Source: Calculated by the authors.

meeting the rising costs. His mother, in her late 60s, who lives with the family under the same roof (but having her own kitchen), is increasingly having to supplement the family food expenses with the small pension she receives as the widow of an ex-army officer.

Peter and his family's situation not only highlights the continued nurturance role played by older people in the family, but also the need for income support for older people from low-income families (Ling 2009).

The above scenarios are those with families, and may have misled us to think that only those who are married with families are affected; on the contrary we found a number of young single persons who have to support either parents or younger siblings.

Jamilah, a single woman aged 22, who completed her senior secondary school three years ago, finds difficulties supporting herself and her 53-year-old mother, with a monthly income of RM650 from her waitressing job. Her mother, suffering from diabetes, had recently stopped working as a cleaner. They had to move into a cheaper and smaller rented house after her mother lost her source of income. Her mother received treatment from a government polyclinic and was given medication every three months. However, according to Jamilah, the medication was not enough to last for three months, and when they approached the polyclinic for more the clinic refused to supply any. This means that that she has to buy medicine from the pharmacy to relieve her mum from the severe pain. For Jamilah, this is at the expense of buying things for herself such as new clothes or a mobile phone subscription. Though she has thought of finding a part-time job or a higher-paid job in some other places to support the family's increasing expenses, she had to give up the idea as no one is helping to care for her mother.

Mimie, aged 27, who works as a shop attendant earning RM700 per month, stated that she cannot survive with her income from one job alone. Supporting her two younger siblings who are not working and a mother who suffers knee pain, Mimie cannot enjoy her leisure time as freely as others of her age. She has to work part-time during the night just to earn an extra RM350 in order to send remittances to her family staying back in the village. Mimie said that sometimes she has to forgo her meals so that she can save enough to send back to the village. Her rented room is getting more expensive; rising transportation costs meant that she goes back to her village less frequently.

Regina, a 21-year-old single woman, who has to support her 49-year-old mother and two younger siblings aged 17 and 15, showed her helplessness during the interview. Her father passed away just three months ago and her sick mother is unable to work. Thus, with only a senior secondary school qualification, she has to take over the responsibility from her parents to earn a living for the family by working as a shop attendant earning RM800 a month. She was sad to mention that her two younger siblings have to stop going to tuition classes even though they are going to sit for important SPM (senior secondary) and PMR (junior secondary) examinations respectively at the end of this year as she could not afford to pay for the rising private tuition fees. The family has to spend thriftily and can only afford to buy the cheapest grade of rice for their daily consumption. She related that even though her mother is sick, she sometimes has to help as a babysitter just to earn some extra income for the family. Her mother once pawned off her jewellery in order to pay arrears of their bills.

From the above, it is evident that the rising costs of food and services has affected low-income groups in the two urban regions covered in the study. They are the lower-paid occupational groups, female-headed households, migrants from rural to urban towns, and those with bigger and growing families or ailing parents. Of concern is that for a number of people who are the sole breadwinner of the family, they have no other means of support but to work additional hours at the expense of their health. The risk to poor health is further compounded when quality health care (quite often equated with private health care) is beyond their means. Their children's educational performance may also be at stake as private tuition gets the slash when these children from the lower socio-economic strata are sometimes more in need of it. A lot of them claimed that they were in fact very unwilling to sacrifice those but they had no choice when facing the rising cost of living. The inaccessibility of facilities to help improve educational performance or to receive quality health treatment among the

poor and poverty are undoubtedly mutually reinforcing, causing them and their children to slip into poverty; and further more, breaking out of the poverty cycle appears unattainable.

While the majority of respondents were negatively affected by inflation and the recent global recession, some interesting findings also emerged from this study. The rising cost of living and the threat of unemployment had many respondents stating that they are putting up their very best to perform well in their workplace. A number of respondents have changed their lifestyles to healthier ones after the rising costs and recent economic recession. For instance, some of the respondents revealed that they used to spend more time together with their friends till late at night at pubs; however, facing financial constraints due to rising costs of living exacerbated by the recent economic recession, they have no choice but to stay at home and spend more time with their family members. In addition, a number of the respondents have also changed their spending behaviour from extravagant spending to prudent spending. Some had cut off their expenses on cigarettes, and a few even quit smoking in order to meet the rising costs for food, which they considered as top priority.

Flora, a 24-year-old single woman said that she has cut down dramatically on her extravagant spending on three to five pieces of branded clothes per month and has reduced the number of nights out for entertainment. From a rural town 70 km from Kuching, Flora works as an attendant in a supermarket in Kuching and is paid RM700 a month. With her income, she supports her two younger siblings who are staying with her in a rented room in Kuching. With the savings on clothes and entertainment, she is able to continue sending remittances home to her elderly parents who stay at the village.

Mei Lan, a 26-year-old married woman also said that she has foregone her spending on cigarettes, gambling (buying lottery tickets), buying new clothes for herself, and entertainment at night. This is to save enough for food and schooling expenses for her four children ranging from 2 to 10 years old, as these expenses come from her earnings of RM800 a month from her job as a sales attendant at a mobile phone outlet. She maintained that her husband's income (the exact amount not disclosed, but their combined income is below RM2,500) is basically just enough to cover the monthly car and house installments and electricity and water bills.

From the two above case studies, it appears that the rising cost of living and the recent economic recession may have brought some positive impact to the lifestyles of some of the respondents. The rising costs of all expenses have forced some of the respondents to reduce purchases of cigarettes and frequency of entertainment out at night, and consequently bring about wiser spending

and a healthier lifestyle. Notwithstanding this, the predicament experienced by the respondents of this study raises a pertinent question related to the kind of social safety net programmes available to cushion the impact of inflation for people in the low-income strata. We now turn to an examination of the existing social safety net programmes available in Sarawak.

SOCIAL SAFETY NET

Social safety net is a term to refer to a collection of services and programmes provided by the state such as social security benefits, unemployment benefit, universal health care, housing provision to protect people against falling into poverty. However, it may be used differently in different countries and by different people. As noted in a Social Safety Nets Seminar conducted by the Asian Development Bank Institute (2001), in the Southeast Asian regions, social safety nets tend to be used to refer to schemes addressing short-term concerns by assisting vulnerable people to stop them falling into poverty (poverty avoidance) or those to improve the living conditions of the poor (poverty reduction). The term social protection schemes is therefore suggested as they are designed for wider coverage which includes statutory systems such as social insurance, provident funds and employer liability funds, area-based and micro-based schemes such as micro-insurance, social funds and public works programmes, social assistance, labour market policies, and child protection (Asian Development Bank Institute 2001).

The recent announcement by the Ministry of Women, Family and Community Development promising delivery of social safety net programmes including the development of education and health provision to all Malaysians, especially poor families ("Help For the Needy" 2009), suggests a bridging between the two types of programme. In addition to the Ministry of Women, Family and Community Development, various ministries and government agencies, including the Ministries of Health, Education, Housing and Local Government, Human Resources, Agriculture and Agrobased Industry, Entrepreneur and Cooperative Development, Rural and Regional Development are involved. The social support given comes in various forms, which include financial aid; food, fertilizer, and fuel subsidies; free education, textbooks, and uniforms; affordable hospital care; and skills training.

For the purpose of this chapter, we will examine the range of social protection schemes in Sarawak, which include social safety net programmes; however, a specific focus is directed at how or whether social safety net programmes are able to "catch" the urban low-income groups to prevent them from falling into poverty.

In Sarawak, social protection is a concurrent matter with federal ministries in Malaysia, although there are schemes implemented in Peninsular Malaysia that are not extended to Sarawak. Similarly, there are also social/public assistance schemes introduced and administered by the state governments.

Firstly, there are several social security schemes extended from the federal government available for workers in the formal and organized sectors including (1) the Employer's Liability Scheme (ELS) covering employment injury compensation and sickness and maternity benefits; (2) the civil service pension, a non-contributory pension scheme for civil servants; (3) the Employee Provident Fund (EPF) for all workers not covered by the civil service pension (those in the army are covered by the Armed Forces Provident Fund); and (4) the Workers' Compensation Scheme to compensate workers in the case of death or accident.

Complementing the above schemes is the insurance scheme introduced under the Social Security Act 1969. The scheme covers workers who earn less than RM2,000 a month and is administered by a central government agency, the Social Security Organisation (SOCSO). The agency also administered an Employment Injury scheme and an Invalidity Pension scheme. The former scheme provides medical benefit, temporary disability benefit, permanent disability benefit, dependents' benefit, death benefit, and rehabilitation benefit. The latter provides coverage against invalidity or death due to any cause. The benefits provided are related to temporary or permanent disability and rehabilitation, funeral grant, survivors' pension, and educational benefits. Benefits are paid out in the form of periodical payments, calculated on an earnings-related basis. It must be stressed that these schemes do not cover those who are self-employed, those employed by small unregistered businesses, domestic helpers, and foreign workers.

Secondly, a range of social safety net programmes are provided through various government departments, statutory and non-governmental organizations. The State Social Welfare Department, under the jurisdiction of the Ministry of Social Development and Urbanisation, administers several welfare assistance schemes, which are means tested. These include (1) Family Assistance (Bantuan Am Keluarga), (2) Elderly Persons Assistance (Bantuan Orang Tua), (3) Children Assistance (Bantuan Kanak-kanak), (4) Foster Children Assistance (Bantuan Anak Pelihara), (5) Workers with Disabilities Allowance (Elaun Pekerja Orang Kurang Upaya), (6) Schooling Assistance (Bantuan Sekolah), (7) Assistance to Youths Undergoing Training (Bantuan Kepada Belia dan Beliawanis dalam Latihan), (8) Assistance for Artificial Aids (Bantuan Alat Ortopedik/Alat Tiruan), (9) Launching Assistance (Bantuan Pelancaran), and (10) Disaster Relief Assistance (Bantuan Bencana). In recent

years, schemes (2), (3), (4) and (5) have been integrated with the equivalent schemes under the Federal Department of Social Welfare, with funding from the latter. Following this, the eligibility criteria have been revised to extend to those whose family income is below the poverty line income of RM830, dovetailing with the PLI for Sarawak. Interviews with the Social Welfare Department, Sarawak, however, revealed that the poverty line income only serves as a initial entry point for eligibility of aid. Final approval will depend on investigations by welfare officers who will look into factors like the living conditions of the families, the number of children and dependants, age of applicant or head of household, physical disability, and health conditions.

Applying these additional factors, families whose incomes are below RM830 a month but who have able-bodied breadwinners are mostly ineligible for the Family Assistance scheme. They may nevertheless be eligible for the Children Assistance which is provided at a rate of RM100 a month per child to a maximum of RM450 per family. However, priority for this assistance is given to single mothers and families in which the head of household is incapacitated either with disabilities, old age, or chronic sickness. Thus, despite the recent introduction of a project reaching out to the poor (Projek Cari), families such as those mentioned in the earlier paragraphs appear to be outside the scope of the safety net.

Apart from the schemes administered by the Social Welfare Department, the Eradication of Hardcore Poverty Programme (Program Pemulihan Rakyat Termiskin, PPRT) managed by the district offices is another scheme introduced in 1989 to deal specifically with hard-core poor households. This scheme gives priority to areas and groups with high incidences of poverty and placed primary emphasis on income-generating projects. These projects focused on the commercial production of cash crops, livestock, and fish rearing, some of which were carried out in cooperation with the private sector. The scheme will be "out of reach" of the urban low-income groups given its emphasis more on rural hard-core poor.

One scheme which specifically addresses urban poverty is the Urban Poverty Eradication scheme launched in 2006 under the Ninth Malaysian Plan and implemented in Sarawak since September 2007. Administered by the local municipal council, households in the urban areas (defined as those who pay rates to the council) with an income below that of PLI are eligible to apply for the different types of assistance. The current PLI of RM860 of a family of five is calculated as an average of RM190 so that the eligibility criteria are adjusted according to the size of the family. The types of assistance provided include (1) rental assistance, (2) school entrance fee assistance, (3) childcare fee assistance, (4) transportation cost assistance, (5) kidney dialysis

treatment assistance, (6) assistance for technical training and allowances, and (7) a one-off relief for poor families (RM2,000 for the poor and RM3,000 for the hard-core poor).

The eligibility criteria of the Urban Poverty Eradication scheme appear to offer a ray of hope for low-income families needing assistance. However, it is of concern that the respondents of this study are mostly not aware of this scheme, or a small number are simply not confident that they would be considered for the assistance. In addition, interview data with council officials could not ascertain whether the increase in the number of applications indicates a greater need for assistance due to the current rising cost and recession or whether it is simply because more get to know about the scheme through relatives and neighbours. Further research will need to be conducted to obtain a profile of who are assisted by the scheme, what sort of assistance is provided, and who may actually be in need of help but are not granted assistance because they do not meet the criteria.

DISCUSSION AND CONCLUDING REMARKS

It is apparent from this study that although a number of social safety net programmes are in place, either carried out through the federal or state governments, some of these are not designed to catch those who may become vulnerable to fall into poverty as a result of rising costs of living. Many of the respondents did not know how they could access this assistance. Some are not even aware of the existence or availability of any kind of assistance.

Yet the impact of rising costs of living on the low-income families has indeed taken a toll on their lives and has plunged them into poverty. This situation has already been noted in previous studies related to the 1997–98 financial crisis which exposed the inadequacy of the existing social protection systems to protect those at the borderline of the PLI (Ragayah 2002, 2004; Sity Daud 2000). The greater vulnerability of the urban poor and low-income groups warrant a number of policy approaches in extending social safety nets to them. This is particularly crucial to avoid the worsening income gap between the rich and the poor, especially due to the rising cost of living.

Even though the government had announced the increased allocation of the budget for the Social Safety Net (SSN) that covers welfare, medical benefits, unemployment benefit, care centres, and even subsidies to help those in need under the Malaysia 2009 Budget, such aid was not widely known about by the public, especially the disadvantaged groups in Sarawak. The increase in allocation of the SSN budget in 2009 to RM800 million, an increase of RM500 million, compared with only RM300 million in 2007 and

2008 intended to benefit 110,000 families all over the country ("Help For the Needy" 2009) will need to be strategically implemented and monitored.

In addition, a fairer and more transparent system in executing the SSN programme is deemed critical to ensure that people from different states within Malaysia and within both rural and urban regions of all states and regardless of ethnicity are receiving the kind of assistance they need.

Any successful social safety net programme must not only contribute to poverty reduction, but must also be able to address the vulnerability of those at risk of falling into poverty. As noted in this study, the rising cost of living in 2008 and 2009 has pushed a certain number of people into hardship as they are not eligible for assistance either from the Welfare Department or other related agencies which uses PLI as the cut-off point for eligibility. It is urgent that PLI be redefined in order to reflect the rising cost of living. A per capita income rather than a household income is also recommended, particularly considering there are families with more than five members as well as the presence of extended families living together in the same household.

The social safety net will involve the participation of the Finance Ministry, the Women, Family and Community Development Ministry, Education Ministry, Health Ministry, Housing and Local Government Ministry, Agriculture and Agro Based Industry Ministry, and the Rural and Regional Development Ministry. Since there are many ministries involved, coordination among the ministries is deemed crucial to ensure the successful implementation of any social safety net programme. Without concerted efforts at various levels, the vision of the Ninth Malaysian Plan (EPU 2009*b*) to fully eradicate hard-core poverty by 2010, and reducing poverty from 5.7 per cent to 2.8 per cent may be an illusion. Similarly, for Sarawak, the target to fully eradicate hard-core poverty will be unattainable.

Notes

1. The PLI in Malaysia is defined as an income sufficient to purchase the minimum requirements of a household for food, clothing and footwear, and other non-food items such as rent, fuel, and power. For the food component, the minimum expenditure was based on a daily requirement of 9,910 calories for a family of five comprising an adult male, an adult female, and three children of either sex within 1–3, 4–6, 7–9 years of age. The minimum requirements for clothing and footwear were based on standards set by the Department of Social Welfare for the requirements of residents in welfare homes. The other non-food items were based on the level of expenditure of the lower-income households as reported in the HES (UNDP 2005).
2. All names used in this paper are pseudonyms.

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